BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	R-2020-3018929
Office of Consumer Advocate	:	C-2020-3022400
Office of Small Business Advocate	:	C-2020-3022414
Philadelphia Area Industrial Energy Users Group	:	C-2020-3022745
	:	
v.	:	
	:	
PECO Energy Company	:	

RECOMMENDED DECISION

NON-PROPRIETARY

Before
Christopher P. Pell
Deputy Chief Administrative Law Judge

TABLE OF CONTENTS

I. INTRODUCTION 1
II. HISTORY OF THE PROCEEDING 1
III. PUBLIC INPUT HEARINGS 5
IV. LEGAL STANDARDS/BURDEN OF PROOF 8
V. DISCUSSION 10
- A. Rate Increase Request 10
  - 1. PECO's Position 10
  - 2. I&E's Position 10
  - 3. OCA's Position 11
  - 4. OSBA's Position 11
  - 5. CAUSE-PA's Position 12
  - 6. PAIEUG's Position 12
  - 7. ALJ's Recommendation 14
- B. Rate Base 17
  - 1. PECO's Position 18
    - a. Fair Value 18
    - b. Utility Plant in Services 19
      - i. The Company's Claim 19
      - ii. The OCA's Recommended Allowance for Fully Projected Future Test Year Plant Additions 20
      - iii. I&E Proposed Adjustment to PECO's Forecasted Plant Additions for the Natural Gas Reliability Project 23
    - c. Depreciation Reserve 25
    - d. Additions to Rate Base 26
      - i. Projected Plant Additions 26
      - ii. Pension Asset 26
      - iii. Uncontested Items 29

1. Cash Working Capital 29
2. Other Non-Contested Rate Base Additions 30
2. I&E 's Position 30
a. Fair Value 30
b. Utility Plant in Service 31
c. Depreciation Reserve 32
d. Additions to Rate Base 32
i. Projected Plant Additions 32
ii. Pension Asset 34
iii. Uncontested Items 37
3. OCA's Position 38
a. Fair Value 38
b. Utility Plant in Service 38
c. Depreciation Reserve 38
d. Additions to Rate Base 39
i. Projected Plant in Service 39
ii. Pension Asset 42
iii. Uncontested Items 46
4. OSBA's Position 46
5. CAUSE-PA's Position 46
6. PAIEUG's Position 46
7. ALJ's Recommendation 46
a. Utility Plant in Service 46
b. Pension Asset 48
c. Cash Working Capital 49
d. Neighborhood Gas Pilot Rider 50
e. Uncontested Items 50
C. Revenues 51
1. PECO's Position 51

2. I&E's Position 52
3. OCA's Position 54
4. OSBA'S Position 54
5. CAUSE-PA's Position 54
6. PAIEUG's Position 54
7. ALJ's Recommendation 54

D. Expenses 56
1. PECO Position 56
a. Payroll and Payroll Related Expenses 56
i. The OCA's Proposed Adjustment 57
ii. I&E Proposed Vacancy Rate Adjustment 59
iii. Employee Benefits Expense and Payroll Taxes 60
b. Contracting and Materials Expenses 60
c. Outside Services (Including Exelon Business Services Company Charges) 62
d. Other Post-Employment Benefits Expenses 64
e. Costs to Achieve Exelon/ PHI Merger 66
f. Regulatory Commission Expenses/General Assessments 68
g. Research and Development Expenses 68
h. Employee Activity Costs 69
i. Travel meals and Entertainment 70
j. Membership Dues 71
k. Injuries and Damages 72
l. Property Taxes 73
m. Energy Efficiency and Conservation program Costs 75
i. I&E Recommendation to Disallow New Program Rebate Costs 75
ii. OCA Criticism of the Cost-Effectiveness of the EE&C Program 76
n. Rate Cost Expenses Normalization 76
o. Regulatory Initiatives 78

p. Manufactured Gas Plant Remediation Expenses 79
q. Depreciation Expense 80
2. I& E Position....81
a. Payroll and Payroll Related Expenses 83
b. Contracting and material Expenses....84
c. Outside Service (Including Exelon Business Service Company Charges) 84
d. Other Cost-Employment Benefits Expenses....86
e. Costs to achieve Exelon/PHI Merger....88
f. Regulatory Commission Expenses/General Assessments 89
g. Research and Development Expenses 90
h. Employee Activity Costs 90
i. Travel, Meals and Entertainment....91
j. Membership Dues 92
k. Injuries and Damages....93
l. Property Taxes 94
m. Energy Efficiency and Conservation Program Costs....94
n. Rate Case Expenses Normalization 96
o. Regulatory Expenses....97
p. Manufactured Gas Plant Remediation Expense....98
q. Depreciation Expense 98
r. Cash Working Capital....98
3. OCA's Position 99
a. Payroll and Payroll Related Expenses 99
i. Employee Headcount....100
ii. One-time Cash Payment for Ratification of the Union Contract....101
b. Contracting and Materials Expenses....102
c. Outside Services (Including Exelon Business Service Company Charges)....104
d. Other Post-Employment Benefits Expenses 106

e. Costs to Achieve Exelon/PHI Merger 107
f. Regulatory Commission Expenses/General Assessments 108
g. Research and Development Expenses 109
h. Employee Activity Costs 110
i. Travel, Meals and Entertainment 111
j. Membership Dues 112
k. Injuries and Damages 112
l. Property Taxes 114
m. Energy Efficiency and Conservation program Costs 115
n. Rate Case Expense Normalization 116
o. Regulatory Initiation 118
p. Manufactured Gas Plant Remediation Expense 118
q. Depreciation Expense 120
4. OSBA's Position 121
5. CAUSE-PA's 122
6. PAIEG's Position 122
7. ALJ's Recommendation on Expenses 122
a. Payroll and Payroll Related Expenses 123
b. Contracting and materials Expense 122
c. Outside Services (Including Exelon Business Company Charges) 123
d. Other Post -Employment Benefit Expenses 125
e. Costs to Achieve Exelon/PHI Merger 126
f. Regulatory Commission Expenses General Assessments 126
g. Research and Development Expenses 127
h. Employee Activity Costs 128
i. Travel, Meals and Entertainment 128
j. Membership Dues 129
k. Injuries and Damages 129
l. Property Taxes 130
m. Energy Efficiency and Conservation Program Costs 131
n. Rate Case Expense Nominalization 132

o. Regulatory Initiatives 133

p. Manufactured Gas Plant 133

q. Depreciation Expense 135

E. Taxes 135

1. PECO's Position 135

2. I&E's Position 135

3. OCA's Position 136

4. OSBA's Position 138

5. CAUSE-PA's Position 138

6. PAIEUG's Position 138

7. ALJ's Recommendation on Taxes 138

a. Payroll Tax Expense 138

b. property Tax Expense 138

F. Rate of Return 139

1. PECO Position 139

a. Introduction 139

b. Capital Structure 141

c. Cost of Long-Term Debt 143

d. Common Equity Cost Rate 144

i. Development of the Barometer Group 145

1. Leve Dividend Yield 146

2. Growth Rate 148

3. Leverage Adjustment 149

ii. Capital Asset Pricing Methodology 152

iii. Risk Premium Approach 154

iv. Comparable Earnings Method 156

e. Business Risks and Management Performance 157

f. Other Parties' Equity Cost Recommendation and Principle Areas of Dispute 160

i. Barometer Group 162

ii. DCF Methodology 163

iii. Capital Asset Pricing Methodology 164
iv. Exclusion of Other Cost of Equity Models 166
v. Management Performance 168
2. I&E's Position 169
a. Introduction 169
b. Capital Structure 170
c. Cost of Long-Term Debt 170
d. Common Equity Cost Rate 170
e. Business Risk and management Performance 172
f. Other Parties' Equity Cost Recommendation and Principle Areas of Dispute 174
3. OCA's Position 175
a. Induction 176
i. Overview of the Cost Capital Recommendation 176
ii. The Legal Framework for Determining What Rate is fair to PECO Customers and the Company's Investors 178
b. Capital Structure 178
c. Cost of Long-Term Debt 181
d. Common Equity Cost Rate 181
i. Introduction 181
ii. OCA Witness O'Donnell's Proxy Group Approach Provides the Commission With Useful from All Ten Companies Followed by Value Line's Gas Utility 183
iii. OCA Witness O'Donnell has Relied Upon the Discounted Cash Flow Model, The Commission's Preferred Method Of Setting Common Equity Cost 184
iv. OCA Witness O'Donnell's DCF Analyses Provide a Robust Basis for His Cost of Equity Recommendation 185
1. Application of the DCF Model 185
2. OCA Witness O'Donnell's Dividend Yield Range Is Based on Current Data and Multiple Observation 186

3. OCA Witness O'Donnell's Rate Range is Soundly Supported 187
4. OCA Witness O'Donnell's Final DCF Recommendation 189
v. CA Witness O'Donnell's Capital Asset Pricing Model 190
vi. OCA Witness O'Donnell's Comparable Earnings Analysis 192
vii. OCA's Return on Equity Recommendation 8.75% for PECO Supported and Appropriate to these Current and Future Market Conditions 193
e. Business Risks and Management Performance 194
i. Business Risks 194
ii. PECO Requested Return on Equity Addition Based on Management Performance Should be Rejected 196
1. The Company's Request 196
2. Ratemaking Adjustment for Management Performance is a Matter of Commission Discretion 197
f. Other Parties' Equity Cost Rate Recommendation Dispute 199
i. Overview 199
ii. The Company's Cost of Equity Recommendation is Excessive 200
1. The Company's Proxy Group is Not Appropriate 202
2. PECO Witness Moul's Application of the DCF Method is Flawed 202
3. PECO Witness Moul's Risk Premium and CAPM Analyses are Flawed and Not Appropriate to Determine the Cost of Equity for PECO 203
4. PECO Witness Moul's Comparable Earnings Analysis 204

5. The Gas Utility Industry Return on Equity Developed for DISC Purposes Should Not Be Adopted as a Floor in this Proceeding....205
iii. The 10.24% Return on Equity Presented by I&E Witness Christopher Keller is Overstated and Not Suited to These Unusual Times....206
1. The I&E Proxy Group is too Small....207
2. The I&E DCF Analysis....208
3. The I&E CAPM Analysis....208
4. OSBA Position....210
a. Introduction....210
b. Capital Structure....211
c. Cost of Long-Term Debt....211
d. Common Equity Cost Rate....211
e. Business Risk and management....212
f. Other Parties' Equity Cost Recommendation and Principles Areas of Dispute....213
5. CAUSE Position....213
6. PAIEG's Position....213
7. ALJ's Recommendation on Rate of Return....213
a. Capital Structure....213
b. Cost of Long-Term Debt....215
c. Common Equity Cost....216
d. Business Risks and Management Performance....217
G. Customer Programs and Miscellaneous Issues....219
1. PECO Position....219
a. Recommendations Related to the COVID-19 Emergency....219
b. Universal Service Program....221
c. Neighborhood Gas Pilot Rider....224
d. Energy Efficiency and Conservation Programs....226
e. Quality of Service-Distribution Integrity Management

Programs 228
f. Quality of Service-Leaks and Excavation Damage
Emergency 231
2. I&E Position..233
a. Recommendations Related to the COVID-19..233
b. Universal Service Programs..233
c. Neighborhood Gas Pilot Rider..233
d. Energy Efficiency and Conversation Programs......................................235
e. Quality of Service-Distribution Integrity Management
Programs 235
f. Quality of Service-Leaks and Excavation Damage 236
3. OCA's Position 237
a. Recommendations Related to the COVID-19 Emergency 237
b. Universal Programs..241
i. Energy Burdens..242
ii. In-CAP Arrearage Forgiveness Programs 245
iii. Increasing CAP Enrollment by 50%..246
c. Neighborhood Gas Pilot Rider..248
d. Energy Efficiency and Conservation Programs......................................248
e. Quality of Service-Distribution Integrity Management
Programs 251
f. Quality of Service-Leaks and Excavation Damage 251
4. OSBA's Position..251
5. CAUSE-PA's Position..252
a. Recommendations Related to the COVID-19 Emergency 252
i. Increase Funding for PECO's Hardship Fund 254
ii. Waive Burdensome Hardship Fund Requirements......................255
iii. Waive Income Certification for CAP During State of
Emergency 256
iv. Provide Arrearage Forgiveness for In-CAP Arrears....................256
v. Waive Late Fees and Reconnection Fees for One Year 258

b. Universal Service Programs 258
i. Customer Assistance Program 258
ii. Low Income Usage Reduction Program 261
c. Neighborhood Gas Pilot Rider 263
d. Energy Efficiency and Conservation Programs 263
e. Quality of Service-Distribution Integrity Management Programs 265
f. Quality of Service-Leaks and Excavation Damage 266
6. PAIEUG's Position 266
7. ALJ's Recommendations on Customer Programs and Miscellaneous Issues 267
a. Recommendations Related to the COVID-19 Emergency 267
b. Universal Service Programs 269
c. Neighborhood Gas Pilot Rider 270
d. Energy Efficiency and Conservation Programs 271
e. Quality of Service-Distribution Integrity Management Programs 271
f. Quality of Service-Leaks and Excavation Damage 272
H. Rate Structure 273
1. PECO's Position 273
a. Cost of Service 273
i. PECO's Class Cost of Service Study 273
ii. Other Parties Positions Regarding Cost of Service and PECO's COSS 275
iii. Other Cost of Service Issues 279
1. OCA Witness Watkins-Forfeited Discounts/Non-Base Rate Revenues 279
2. OSBA Witness Knecht 280
b. Revenue Allocation 286
i. PECO's Revised Revenue Allocation 287
ii. Opposing Party Alternative Revenue Allocations 287

iii. Scale back of Rates 288

c. Allocation of Universal Service Program Costs 289

d. Tariff Structure...290

i. Residential Customer Charge 290

ii. Non-Residential Customer Rate Design 293

1. Rate GC Customer Charge..293

2. Rate GC Declining Block Volumetric Charge Differential..294

3. Rate TSF and TS-1 Volumetric Charge Differential..294

4. Rate L and Standby Sales Service 295

5. Elimination of Rate IS Margin Sharing 296

6. Elimination of Rate IS, MV-1 and TCS...........................297

iii. Distribution System Improvement Charge (DSIC) Cost Allocation 298

iv. Negotiated Gas Service...299

v. Theft/Fraud Investigation..301

e. Summary and Alternatives..303

2. I&E ‘s Position...303

a. Cost of Service...303

i. PECO’s Class Cost of Service Study..303

ii. Other Parties’ Position Regarding Cost of Service and PECO’s Cost 304

b. Revenue Allocation..305

i. PECO’s Revised Revenue Allocation...305

ii. Opposing Party Alternative Revenue Allocations 306

iii. Scale Back of Rates 306

c. Allocation of Universal Service Program Costs 307

d. Tariff Structure...308

i. Residential Customer Charge 308

ii. Non-Residential Customer Rate Design 308

iii. Distribution System Important Charge (DSIC) Cost Allocation....309
iv. Negotiated Gas Service....309
v. Theft/Fraud Investigation....310
e. Summary and Alternatives....311
3. OCA's Position....311
a. Cost of Services....311
i. PECO's Class Cost of Service Study....311
ii. Other Parties' Position Regarding Cost of Service and PECO's Coss....313
iii. Other Cost of Service Issues....316
b. Revenue Allocation....316
i. PECO 's Revised Revenue Allocation....316
ii. Opposing Party Alterative Revenue Allocations....319
iii. Scale Back of Rates....321
c. Allocation of Universal Service Program Costs....322
i. Introduction....322
ii. The Issue of Allocation of Universal Service Cost for PECO's Natural Gas Customers Should Be Addressed in These Proceedings....323
iii. The Final CAP Policy Statement Order Identifies the Factors the Commission Will Consider....325
iv. Poverty is Not Just a Residential Class Problem....328
v. Universal Services Programs have Been Economic Benefit....329
vi. The Allocation of Universal Service Costs is Consistent with Sound Ratemaking Principles....332
vii. Proposals to Allocate the Universal Service Costs to Only Residential Customers Should Be Denied....334
d. Tariff Structure....337
i. Residential Customer Charge....337

1. Induction 337
2. Low-Income Customers Will Not Be Protected from the Proposed Increase to the Customer Charge 337
3. The Proposed Increase to the Customer- Charge Will Harm PECO's Low-income Customers 338
4. Low-Income Customers Are Disproportionately Low-Use Customers Who Cannot Otherwise Off-set the Proposed Increased Customer Charge 341

ii. Non-Residential Customer Rate Design 344
1. Rate GC Customer Charge....344
2. Rate GC Declining Block Volumetric Charge Differential 344
3. Rate TS-F and TS-1 Volumetric Charge Differential 344
4. Elimination of Rate IS Margin Sharing 344
5. Elimination of Rate IS, MV-I and TCS 345

iii. Distribution System Improvement Charge (DSIC) Cost Allocation....345
iv. Negotiated Gas Service....345
v. Theft/Fraud Investigation....347

e. Summary and Alternatives....349

4. OSBA's Position 350

a. Cost of Service....350
i. PECO's Class Cost of Service Study....350
ii. Other Parties' Position Regarding Cost of Service and PECO's Coss....351
iii. Other Cost of Service Issues 352

b. Revenue Allocation....353
i. PECO"s Revised Allocation 353
ii. Opposing Party Alternative Revenue Allocations 353
iii. Scale Back Rates....354

c. Allocation of Universal Service Program Costs 355
d. Tariff Structure...357
i. Residential Customer Charge 357
ii. Non-Residential Customer Rate Design 357
1. Rate GC Customer Charge...357
2. Rate GC-Declining Block Volumetric Charge Differential 357
3. Rate TS-F and TS-1 Volumetric Charge Differential 358
4. Elimination of Rate IS Margin Sharing 360
5. Elimination of Rate IS, MV-1 and TCS...........................360
6. Rate L...361
iii. Distribution System Improvement Charge (DSIC) Cost Allocation...364
iv. Negotiated Gas Service 365
v. Theft/Fraud Investigation..367
e. Summary and Alternatives...367
5. CAUSE-PA's Position...367
a. Cost of Service..367
b. Revenue Allocation...367
c. Allocation of Universal Service Program Costs 368
i. The Commission Should Order PECO to Recover Universal Service Costs Equity Across All Rate Classes 368
ii. Cross Class Recovery of universal Services Costs ..... is Consistent with Pennsylvania Law Furthers Critically Important Public Policy Goals to Protect The Health and Safety Of Vulnerable Pennsylvanians...370
iii. The Current Gas Rate Case is the Appropriate Proceeding to Address Recovery of Gas CAP costs..376
d. Tariff Structure...377
i. Residential Customer Charge 377

ii. Non-Residential Customer Rate Design 380
iii. Distribution System Improvement Charge (DSIC) Cost of Allocation 380
iv. Negotiated Gas Service 381
v. Theft/Fraud Investigation 381
e. Summary and Alternatives 381
6. PAIEUG's Position 381
a. Cost of Service 381
i. PECO's Class Cost of Service Study 381
ii. Other Parties' Position Regarding Cost of Service and PECO's Coss 384
iii. Other Cost of Service Issues 390
b. Revenue Allocation 391
i. PECO's Revised Revenue Allocation 391
ii. Opposing Alternative Revenue Allocations 393
iii. Scale Back of Rates 395
c. Allocation of Universal Services Program Costs 397
d. Tariff Structure 403
i. Residential Customer Charge 403
ii. Non-Residential Customer Rate Design 403
1. Rate GC Customer Charge 403
2. Rate GC Declining Block Volumetric Charge Differential 403
3. Rate TS-F and TS-I Volumetric Charge Differential 403
4. Elimination of Rate IS Margin Sharing 405
5. Elimination of Rate IS, MV-I and TCS 406
iii. Distribution System Important Charge (DSIC) Cost Allocation 406
iv. Negotiated Gas Service 406
v. Theft/Fraud Investigation 407

e. Summary and Alternatives..407
7. ALJ’s Recommendations on Rate Structure...408
a. Cost of Services 408
b. Revenue Allocation..409
c. Allocation of Universal Service Program 411
d. Tariff Structure..412
i. Residential Customer Charge 412
ii. Non-Residential Customer Charge 413
1. Rate GC Customer Change..413
2. Rate GC Declining Block Volumetric Charge Differential..414
3. Rate TSF and TS-1 Volumetric Change Differential..414
4. Rate L and Standby Sales Service 415
5. Elimination of Rate IS Margin Sharing 416
6. Elimination of Rate IS,MV-1 and TCS...........................417
iii. Distribution System Improvement Charge Cost Allocation...418
iv. Negotiated Gas Service...418
v. Theft/Fraud Investigation...420
VI. CONCLUSION OF LAW..421
VII. ORDER...423

APPENDIX

A. Table I – Income Summary
B. Table I(A) – Rate of Return
C. Table I(B) – Revenue Factor
D. Table II – Summary of Adjustments
E. Table III – Interest Synchronization
F. Table IV – Cash Working Capital – Interest & Dividends
G. Table V – Cash Working Capital – Taxes
H. Table VI – Cash Working Capital – O&M Expenses

I. INTRODUCTION

This Recommended Decision recommends that PECO Energy Company's proposed Tariff Gas – Pa. P.U.C. No 4, which proposed changes in rates, rules, and regulations calculated to produce an increase of approximately $68.7 million, or approximately 8.9% in additional annual distribution revenue, be denied because the Company has not met its burden of proving by a preponderance of the evidence the justness and reasonableness of every element of its requested increase. Instead, this decision recommends the approval of an increase in annual operating revenue in the amount of $23,892,217 or approximately 4% over present rates. Under the recommended increase, an average residential customer's monthly bill would increase by approximately $3.90, or 5%. The suspension date is June 29, 2021.

II. HISTORY OF THE PROCEEDING

On September 30, 2020, PECO Energy Company (PECO or Company) filed Tariff Gas – Pa. P.U.C. No. 4 to become effective on November 29, 2020. Tariff No. 4 contains proposed changes in rates, rules, and regulations calculated to produce an increase of approximately $68.7 million (8.9%) in additional annual distribution revenue.

On October 6, 2020, Scott B. Granger, Esq., entered a Notice of Appearance on behalf of the Commission's Bureau of Investigation and Enforcement (I&E).

On October 14, 2020, the Office of Consumer Advocate (OCA) filed a Public Statement, a Notice of Appearance on behalf of Phillip D. Demanchick, Esq., Christy M. Appleby, Esq., Barrett C. Sheridan, Esq., Laura J. Antinucci, Esq., and Darryl A. Lawrence, Esq., and a formal Complaint. The Complaint was docketed at C-2020-3022400.

On October 15, 2020, the Office of Small Business Advocate (OSBA) filed a Verification, Public Statement, a Notice of Appearance on behalf of Steven C. Gray, Esq., and a formal Complaint. The Complaint was docketed at C-2020-3022414.

On October 22, 2020, the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania (CAUSE-PA) filed a Petition to Intervene in this proceeding.

By Order entered on October 29, 2020, the Pennsylvania Public Utility Commission (Commission) instituted an investigation into the lawfulness, justness, and reasonableness of the proposed rate increase. Pursuant to Section 1308(d) of the Public Utility Code, 66 Pa. C.S.A. § 1308(d), PECO Tariff Gas - Pa. P.U.C. No. 4 was suspended by operation of law until June 29, 2021, unless permitted by Commission Order to become effective at an earlier date. In addition, the Commission ordered that the investigation include consideration of the lawfulness, justness and reasonableness of PECO's existing rates, rules, and regulations. The matter was assigned to the Office of Administrative Law Judge for the prompt scheduling of hearings culminating in the issuance of a Recommended Decision.

In accordance with the Commission's October 29, 2020, Order, the matter was assigned to Deputy Chief Administrative Law Judge Christopher P. Pell.

On November 5, 2020, the Philadelphia Area Industrial Energy Users Group (PAIEUG) filed a formal Complaint. The Complaint was docketed at C-2020-3022745.

On November 9, 2020, PECO Gas filed Supplement No. 1 to Tariff Gas – Pa.P.U.C. which suspends the rates, rules and regulations proposed in Tariff Gas – Pa.P.U.C. No. 4 until June 30, 2021.

A Call-in Telephonic Prehearing Conference was held on November 9, 2020. Counsel for PECO, I&E, OCA, OSBA, CAUSE-PA and PAIEUG participated.

No party opposed the Petition to Intervene filed by CAUSE-PA. Accordingly, I granted CAUSE-PA's Petition to Intervene during the Prehearing Conference and memorialized their status in my November 10, 2020 Prehearing Order #1.

By Order dated November 12, 2020, I granted PECO's Motion for Protective Order.

On December 10, 2020, telephonic public input hearings were held at 1:00 p.m. and 6:00 p.m.

On December 22, 2020, the following parties served Direct Testimony: OCA (Direct Testimonies of Scott J. Rubin, OCA St. No. 1; Lafayette K. Morgan, OCA St. No. 2; Kevin W. O'Donnell, OCA St. No. 3; Glen A. Watkins, OCA St. No. 4 (Public and Confidential Versions); Roger D. Colton, OCA St. No. 5; and Geoffrey C. Crandall, OCA St. No. 6); I&E (Direct Testimonies of D.C. Patel, I&E St. No. 1; Christopher Keller, I&E St. No. 2 (Proprietary and Non-Proprietary Versions); Ethan H. Cline, I&E St. No. 3; Elena Bozhko, I&E St. No. 4 (Proprietary and Non-Proprietary Versions)); OSBA (Direct Testimony of Robert D. Knecht, OSBA St. No. 1 (Public and Confidential Versions)); CAUSE-PA (Direct Testimony of Mitchell Miller, CAUSE-PA St. No. 1); and PAIEUG (Direct Testimony of Billie LaConte, PAIEUG St. No. 1).

On January 19, 2021, the following parties served Rebuttal Testimony: PECO Gas (Rebuttal Testimonies of Ronald A. Bradley, PECO St. NO. 1-R; Robert J. Stefani, PECO St. No 2-R; Michael J. Trzaska, PECO St. No. 3-R; Paul R. Moul, PECO St. No. 5-R; Jiang Ding, PECO St. No. 6-R; Joseph A. Bisti, PECO St. No. 7-R; Richard A. Schlesinger, PECO St. No. 8-R; Doreen L. Masalta, PECO St. No. 9-R; Kelly Colarelli, PECO St. No. 10-R; and Paul Hibbard, PECO St. No. 11-R); OCA (Rebuttal Testimonies of Kevin W. O'Donnell, OCA St. No. 3-R; Glenn A. Watkins, OCA St. No. 4-R; and Roger D. Colton, OCA St. No. 5-R); OSBA (Rebuttal Testimony of Robert D. Knecht, OSBA St. No. 1-R); and PAIEUG (Rebuttal Testimony of Billie LaConte, PAIEUG St. No. 1-R).

On February 9, 2021, the following parties served Surrebuttal Testimony: OCA (Surrebuttal Testimonies of Scott J. Rubin, OCA St. No. 1-SR; Lafayette K. Morgan, OCA St. No. 2-SR; Kevin W. O'Donnell, OCA St. No. 3-SR; Glenn A. Watkins, OCA St. No. 4-SR; Roger Colton, OCA St. No. 5-SR; and Geoffrey C. Crandall, OCA St. No. 6-SR); I&E

(Surrebuttal Testimonies of D.C. Patel, I&E St. No. 1-SR; Christopher Keller, I&E St. No. 2-SR; Ethan H. Cline, I&E St. No 3-SR (Proprietary and Non-Proprietary Versions); and Elena Bozhko, I&E St. No. 4-SR (Proprietary and Non-Proprietary Versions); OSBA (Surrebuttal Testimony of Robert D. Knecht, OSBA St. No. 1-S (Highly Confidential Version)); CAUSE-PA (Surrebuttal Testimony of Mitchell Miller, CAUSE-PA St. No. 1-SR); and PAIEUG (Surrebuttal Testimony of Billie LaConte, PAIEUG St. No. 1-S).

Also on February 9, 2021, Brandon J. Pierce, Esq., Counsel for PECO, contacted me to advise that the parties were working towards settlement of PECO's Gas Rate Case as well as preparing for hearings. On behalf of the parties, Mr. Pierce requested cancellation of hearings on February 16, 2021, to permit additional settlement time. I granted that request via email on February 10, 2021, and cancelled the hearing scheduled for February 16, 2021.

On February 12, 2021, Kenneth Kulak, Esq., Counsel for PECO, contacted me on behalf of all the parties to advise that the parties anticipated that hearings would still be required. Mr. Kulak further advised that the parties agreed that only one day of hearings would be required and requested that the hearing scheduled for February 17, 2021 be cancelled, and the hearing be held on February 18, 2021. Out of concern that the hearings may take longer than anticipated by the parties, I denied the request via email on February 12, 2021.

The evidentiary hearing was held as scheduled on February 17, 2021. During the hearing, PECO presented its witnesses' rejoinder testimony, and also made its witnesses available for cross examination by the other parties. All other party witnesses were excused from appearing at the hearing since no parties requested to cross examine them, and also because I did not have any questions for them. PECO, I&E, OCA, OSBA, CAUSE-PA and PAIEUG each moved to have their witnesses' testimonies and exhibits entered into the record. As there were no objections, all parties' testimony and/or exhibits were admitted into the record during the hearing. The hearing scheduled for February 18, 2021 was cancelled on the record during the February 17th hearing.

On March 3, 2021, PECO, I&E, OCA, OSBA, CAUSE-PA and PAIEUG filed main briefs. On March 15, 2021, the same parties filed reply briefs. The record closed on March 15, 2021.

III. PUBLIC INPUT HEARINGS

On December 10, 2020, telephonic public input hearings were held at 1:00 p.m. and 6:00 p.m. The hearings were held telephonically due to the ongoing COVID-19 pandemic. A total of eight people testified, with four witnesses testifying at the 1:00 p.m. hearing and four witnesses testifying at the 6:00 p.m. hearing.

Marissa Christie testified on behalf of United Way of Bucks County. Ms. Christie highlighted the ways in which PECO partners with United Way of Bucks County to help create more financially resilient families. Ms. Christie explained how PECO has been presence in the Community helping to create career opportunities for young people. Ms. Christie also expressed her thanks for actions taken by PECO during the COVID-19 pandemic. Ms. Christie noted that PECO has been an active community partner.[1]

Christina McGinley testified on behalf of the Bucks County Community College Foundation. Ms. McGinley testified how PECO has supported several grants with the College's Department of Science, Technology, Engineering and Mathematics (STEM). Ms. McGinley noted how these grants have allowed the college to either create new programs or expand on existing programs. Ms. McGinley testified that in addition to these grants, PECO has supported scholarship assistance over the years for students in the STEM department, which it expanded during the COVID-19 pandemic. Also, PECO has funded a grant for the college's student emergency fund, which awards micro-grants to students who are impacted by the COVID crisis for emergency assistance so they can stay on track to finish their degrees or their credentials. Lastly, Ms. McGinley testified that guidance of PECO leadership on the college's Board of

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[1] Tr. 77-79.

Directors has been instrumental in allowing the college to create and expand on existing programs.[2]

John Rowe testified on behalf of Utility Emergency Services Fund (USEF). Mr. Rowe testified regarding PECO's commitment to the Community and PECO's response to its neighbors during the pandemic. Mr. Rowe testified how USEF and PECO have worked hand-in-hand-in-hand for 37 years to create and fine-tune programs to serve vulnerable families. Mr. Rowe further testified that, through USEF's partnership with PECO, USEF has been able to expand significantly from an organization that only offered utility grants to one that also provides full self-sufficiency through housing stabilization, serving more than 4,000 families per year. Mr. Rowe notes that PECO matches every grant that USEF provides to PECO customers. Moreover, PECO runs the Matching Energy Assistance Fund (MEAF), which raised over $140,000 last year to assist approximately 700 families. Mr. Rowe estimated that PECO provides $1,000,000 in assistance to vulnerable families. Mr. Rowe stressed that PECO always responds to his request for assistance.[3]

John Butler testified that he is not a PECO gas customer, but that he is opposing PECO Gas' expansion in Marple Township. Mr. Butler testified that he is concerned about climate change and the use of fossil fuels and therefore he does not support an increase when they are going to expand their service area. Mr. Butler referred to PECO Gas installing a reliability station in Marple Township, involving a 11.5-mile, 12-inch high, pressure line from Conshohocken into the center of Marple Township. Mr. Butler noted that although the zoning board rejected PECO's application, PECO is continuing with construction. Mr. Butler testified about gas leaks in Marple Township as well as PECO's refusal to provide a list of gas leaks due to confidentiality. Mr. Butler expressed his concerns that PECO will not provide specifications of the equipment that will be used in the reliability center. Mr. Butler expressed additional concerns about the effects the new reliability station will have on air quality in Marple Township.[4]

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[2] Tr. 82-83.
[3] Tr. 85-92.
[4] Tr. 94-101.

Julie Baker testified that in addition to being a PECO customer, she is also an Exelon shareholder. Ms. Baker expressed concerns about the use of natural gas, since natural gas is a source of methane, which she characterized as being worse than carbon monoxide. Ms. Baker also testified about her concerns related to gas leaks on PECO's gas pipelines. Similar to Mr. Butler, Ms. Baker testified about PECO's planned reliability station in Marple Township, as well as the lack of information from PECO on this project. Ms. Baker is concerned about emissions and noise pollution that will be caused by this reliability station in a predominately residential area.[5]

Bob Dorazio testified that he lives approximately 150 feet from PECO's proposed reliability station. Mr. Dorazio expressed his concerns about the emissions that will be produced from the gas-fired generators at the reliability station. Mr. Dorazio testified that due to these emissions, PECO's proposed reliability station should be an area zoned for industrial use. Mr. Dorazio also expressed concerns that the reliability will be aesthetically displeasing in his residential area. Additionally, Mr. Dorazio is concerned about the impacts this reliability station will have on his and his wife's health.[6]

Albert J. Zone testified on behalf of the Elmwood Park Zoo in Norristown. Mr. Zone explained that PECO has been a great partner in supporting the endangered species at the zoo, and in enabling Title I schools, students and faculty, to attend the zoo free of charge in an attempt to help these students with their education. In total, Mr. Zone testified that PECO has been a positive corporate and community partner.[7]

David Oliver testified regarding the benefits of PECO's gas rebates for high efficiency gas equipment as well as their neighborhood gas pilot program. Mr. Oliver explained that he is a contractor, and that PECO's gas rebate program has been an asset to his company to help promote high efficiency equipment for his customers. Mr. Oliver explained that, although the purchase of high efficiency equipment is costly initially, it ultimately saves the consumers

[5] Tr. 126-135.
[6] Tr. 137-141.
[7] Tr. 144-147.

money. Mr. Oliver further testified about PECO's Neighborhood Gas Pilot Program, where PECO identifies neighborhoods where gas is available and urges residents to consider converting to gas from a different source of heating fuel, which benefits the resident with a much higher energy efficient heating system and saves them money.[8]

IV. LEGAL STANDARD/BURDEN OF PROOF

The public utility bears the burden of proof to establish the justness and reasonableness of its requested rate increase. As set forth in Section 315(a) of the Public Utility Code, 66 Pa.C.S. § 315(a):

> (a) Reasonableness of rates – In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

The Commonwealth Court has stated:

> Section 315(a) of the Public Utility Code, 66 Pa.C.S. § 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial.[9]

The Pennsylvania Supreme Court has stated that the party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. Even where a party has established a prima facie case, the party with the burden of proof must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary." [10] Furthermore, it is well-established that the "degree of proof before

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[8] Tr. 149-154.

[9] *Lower Frederick Twp. v. Pa. Pub. Util. Comm'n*, 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980) (citations omitted). *See also, Brockway Glass v. Pa. Pub. Util. Comm'n*, 63 Pa. Commw. 238, 437 A.2d 1067 (1981).

[10] *Burleson v. Pa. Pub. Util. Comm'n*, 461 A.2d 1234, 1236 (Pa. 1983).

administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of the evidence." [11] Additionally, the evidence must be substantial and legally credible, and cannot be mere "suspicion" or a "scintilla" of evidence.[12] Thus, a utility has an affirmative burden to establish the justness and reasonableness of its rate request.

However, as the Commonwealth Court has explained: "While it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged."[13] Therefore, while the ultimate burden of proof does not shift from the utility, a party proposing an adjustment to a ratemaking claim bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment.[14] Furthermore, a party that raises an issue that is not included in a public utility's general rate case filing bears the burden of proof regarding that issue.[15]

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11 *Lansberry v. Pa. Pub. Util. Comm'n*, 578 A.2d 600, 602 (Pa.Cmwlth. 1990).

12 *Lansberry*, 578 A.2d at 602.

13 *Allegheny Cntr. Assocs. v. Pa. Pub. Util. Comm'n*, 570 A.2d 149, 153 (Pa.Cmwlth. 1990).

14 *See, e.g., Pa. Pub. Util. Comm'n v. PECO Energy Co.*, Docket No. R-891364, 1990 Pa. PUC LEXIS 155 (Order entered May 16, 1990); *Pa. Pub. Util. Comm'n v. Breezewood Tel. Co.*, Docket No. R-901666, 1991 Pa. PUC LEXIS 45 (Order entered January 31, 1991).

15 *Pa. Pub. Util. Comm'n et al. v. Columbia Gas of Pa., Inc.*, R-2010-2215623 at 28 (Opinion and Order dated October 14, 2011).

V. DISCUSSION

A. Rate Increase Request

1. PECO's Position

PECO submits that 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 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. PECO RB at 1-2.

2. I&E's Position

I&E submits that PECO Energy Company - Gas Division has failed to present substantial credible record evidence to support its request for a $68.7 million revenue requirement increase. Based upon I&E's adjustments following hearings and the creation of a full evidentiary record on all issues, the record evidence proves that only a revenue increase of $26.3 million is warranted. This recommendation is based upon the adjustments offered by I&E, as set forth more fully herein and summarized in Table I (Income Summary), Table II (Summary of I&E Adjustments), and Table III (Rate of Return) collectively attached to I&E's Main Brief as Appendix "A." I&E MB at 5.

3. OCA's Position

The OCA opposes any increase to PECO's rates at this time. Throughout the Commonwealth as a whole, and particularly within PECO's service territory, ratepayers are still firmly in the grip of the COVID-19 Pandemic and the impacts to the health of the citizenry and the local economy are devastating. This is not the time to raise rates on PECO's customers. The evidence of record in this matter shows that PECO is not in need of immediate rate relief. PECO's current and near-term financial outlook is stable. PECO currently has sufficient revenues to continue to provide safe and reasonable service, to continue its construction activities, pay all of its expenses and earn a profit. OCA MB at 8.

4. OSBA's Position

The OSBA submits: that the Commission should award PECO an Return on Equity (ROE) of no more than the 8.75 percent; that the Commission grant no upward adjustment to PECO's awarded ROE for the Company's management performance; that the Commission should adopt either the COSS presented by the OSBA or the COSS presented by the OCA in this proceeding; that the Commission should adopt any of the Rate GC revenue allocation proposals of PECO, the OCA, or I&E; that the Commission should adopt the revenue allocation proposals for the TS-F and TS-I classes presented by either the OSBA or the OCA; that the Commission should apply the OSBA's hybrid scaleback mechanism to any reduction in the overall proposed revenue increase; that the Commission should adopt PECO's proposal to continue to recover costs for the Company's Universal Service programs for low-income customers from the Rate GR residential class; that the Commission should adopt PECO's revised proposed customer charge for Rate GC of $28.55 per month; that the Commission should adopt PECO's revised proposed declining block rates for Rate GC as set forth in PECO's rebuttal testimony; that the Commission should adopt PECO's revised proposal for rate differentials between the small and large customers in Rates TS-F and TS-I; that the Commission should adopt PECO's revised proposal to eliminate the Rate IS margin sharing mechanism; that Rate L service should be limited to the regular high load factor customers as it was intended and designed; that the Commission should require that transportation of PECO's standby supply gas be made using the transportation rates within the TS-F and TS-I tariffs; and that the Commission adopt strict policies and procedures regarding the use of negotiated rates for larger customers. OSBA maintains that PECO has not met its burden with respect to negotiated rates for five of its six Rate NGS customers, and that PECO's claimed revenue increase should be reduced by the amount of the unjustified rate discounts to these five customers. OSBA MB at 2-3.

5. CAUSE-PA's Position

CAUSE-PA submits that it is both unjust and unreasonable to raise rates on essential natural gas service as the economic impact of the COVID-19 pandemic continues to unfold in unpredictable and uncertain ways. The evidence in this proceeding is clear that the breadth and severity of poverty in PECO's service territory – and across the state – is growing at alarming rates. The pandemic has taken an especially heavy toll on both the economic and public health of low-income and minority households, which already faced disproportionately high energy costs compared to higher income households before the pandemic. Raising rates on natural gas to power heat and hot water, essential to curbing the spread of COVID-19 – would increase already high rates of involuntary termination, exacerbating the disproportionate health impacts of the pandemic on low-income communities and communities of color and prolonging the longer-term economic recovery for these same households. CAUSE-PA MB at 6.

CAUSE-PA maintains that the record in this proceeding demonstrates that PECO's existing rates are already categorically unaffordable for a substantial portion of PECO's residential customer class – even for those enrolled in PECO's Customer Assistance Program (CAP). Rather than further exacerbate existing unaffordability, CAUSE-PA urges the Commission to instead approve its proposals for targeted reforms to PECO's existing universal service programs and policies, as well as additional short-term measures capable of addressing the economic devastation caused by the ongoing COVID-19 pandemic. CAUSE-PA MB at 6.

6. PAIEUG's Position

In this proceeding, PECO is seeking to increase its natural gas revenues by $68.7 million. While PAIEUG did not present any testimony on this specific issue, PAIEUG recognizes that several other parties, including the OCA, OSBA, and I&E, have raised significant concerns regarding whether such an increase is appropriate. Specifically, these parties have questioned, among other things, whether PECO's proposed Return of Return, Return on Equity, and claimed expenses are appropriate, especially in light of the on-going COVID-19 pandemic.[16] PAIEUG agrees that the PUC must fully review PECO's request, including the issues raised by I&E, OCA, and OSBA to ensure that any rate increase request is just and reasonable. PAIEUG MB at 5.

Moreover, as noted by the PUC recently, the Commission has broad discretion in determining whether rates are reasonable, and the Commission is vested with the discretion to decide what factors it will consider in setting or evaluating a utility's rates.[17] To that end, the Commission is permitted to consider and weigh important factors in setting rates, including quality of service, gradualism, and rate affordability.[18] Accordingly, PAIEUG submits that the Commission must consider the unique circumstances the COVID-19 pandemic has effected with respect to changes in service, market forces, and the economy.[19] Specifically, the PUC 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 present today. Only in doing so can the PUC ensure that PECO's resulting rates are just, reasonable, and appropriate for all customers. PAIEUG MB at 5-6.

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16 *See* Bureau of Investigation and Enforcement Statement No. 1, *Direct Testimony of D.C. Patel* ("I&E Statement No. 1"), pp. 3-4; Office of Small Business Advocate Statement No. 1, *Direct Testimony of Robert D. Knecht* ("OSBA Statement No. 1"), pp. 6-14; Office of Consumer Advocate Statement No. 1, *Direct Testimony of Scott Rubi*n ("OCA Statement No. 1"), pp. 8-26.

17 *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa., Inc*.; Docket No. R-2020-3018835 (Opinion and Order dated Feb. 19, 2021), p. 44 ("*Columbia*").

18 *Id*. at 48.

19 *Id.*

7. ALJ's Recommendation

PECO initially sought a $68.7 million increase to its revenue requirement and an increase in the fixed residential charge, from $11.75 per month to $16.00 per month. During the proceeding, PECO reduced its revenue requirement to approximately $66.2 million.[20] Due to the ongoing COVID-19 Pandemic and the impact it is having on the citizens and local economy, the OCA and CAUSE-PA oppose any increase to PECO's rates.

Specifically, the OCA argues that PECO's existing rates are more than sufficient given the current COVID-19 Pandemic and associated financial hardships facing its ratepayers and would allow PECO, under its claims for the FPFTY ending June 30, 2022 to recover all of its claimed expenses and debt costs (without any adjustments to the Company's FPFTY projections) and earn a return on equity of 7.27%. The OCA further argues that the Commission has the authority and discretion to deny the requested rate increase so long as that amount is not confiscatory, and the utility has the opportunity to earn a fair rate of return. Also, the OCA argues that raising natural gas rates on PECO's customers during this time would not meet the just and reasonable requirements of Section 1301 of the Public Utility Code.[21]

For its part, CAUSE-PA argues that the COVID-19 pandemic has thrust Pennsylvania into an unprecedented time of great economic uncertainty, which it maintains has fallen hardest on low-income communities. CAUSE-PA recognizes that the state has begun the slow process of recovery and reopening, but that those efforts have been met with continual setbacks, which CAUSE-PA posits makes the future difficult to predict. CAUSE-PA provided a variety of data to support its argument regarding the economic impact the pandemic is having on Pennsylvania residents, including: that as of December 12, 2020, almost 2.5 million Pennsylvania residents had filed for unemployment since the start of the pandemic, representing over 19% of the state's total population; that as of November 30, 2020, residential utility debt for regulated natural gas, electric, and water service was up 71% year over year, from $429.5 million

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20 PECO St. No. 3-R at 2.
21 66 Pa. C.S. § 1301.

to $734.5 million, and the number of residential customers eligible for termination was up 35% year over year, from 663,349 to 894,944; that as of December 30, 2020, 139,890 of PECO's residential customers were eligible for termination; and that moratoria on utility terminations nationwide through the course of the pandemic have reduced COVID-19 infections by 4.4%, and have reduced COVID-19 mortality rates by 7.4%.[22] CAUSE-PA believes that raising rates in the midst of this pandemic will result in increased expenses and involuntary payment-related terminations.

In further opposition to the proposed rate increase, CAUSE-PA argues that PECO's rates are already unaffordable for economically vulnerable consumers, who will likely experience increased payment trouble and termination if the proposed rate increase is approved. Based on the uncertainty caused by the pandemic, CAUSE-PA believes it is inappropriate to approve an increase in natural gas rates until the economic impact of the pandemic on communities can be fully assessed.

PECO responded to these arguments by noting that the Commission recently concluded in the *Columbia Gas* case that the economic effects of the COVID-19 pandemic are, by themselves, not a basis for the denial of a rate increase.[23] PECO further responded that the evidence presented in this proceeding demonstrated that PECO's existing rates are not sufficient to generate a sufficient return on investment.

As previously noted, the Commission addressed similar COVID-19 arguments in the recent Columbia Gas case. In that case, the Commission stated:

> [T]he Commission "has broad discretion in determining whether rates are reasonable" and "is vested with discretion to decide what factors it will consider in setting or evaluating a utility's rates." *Popowsky II*, 683 A.2d at 961. Included in the Commission's broad ratemaking authority is the authority to approve alternative rates and rate mechanisms, including formula rates as well as

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22 *See* CAUSE-PA St. 1 at 14-15; CAUSE-PA St. 1-SR at 8-9.

23 *Pa. Pub. Util. Comm'n v. Columbia Gas,* R-2020-3018835 at 48-51 (Opinion entered February 19, 2021.)

> decoupling mechanisms, performance-based rates, and multiyear rate plans.[24]

In response to concerns about increasing rates amidst the COVID-19 pandemic, the Commission further stated:

> Thus, it is our responsibility under the applicable legal and constitutional standards to weigh evidence and unique considerations related to the COVID-19 pandemic in setting just and reasonable rates, and our continued use of traditional ratemaking methodologies permit our consideration of important ratemaking principles, like gradualism and rate affordability, in relation to this pandemic.[25]
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> 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. Indeed, we are not persuaded by the argument that the final rates in the other cases were the results of settlement agreements, as that fact alone does not change the reality that such settlements would not be effective unless approved under our ratemaking authority, and we clearly acknowledged the need for revenue increases during this pandemic for these companies by approving the settled-upon rate increases after we found that such settlements were in the public interest and resulted in just and reasonable rates. *See PGW Rate Order, UGI Gas Rate Order, PWSA Rate Order*.[26]

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24 *Pa. Pub. Util. Comm'n v. Columbia Gas*, R-2020-3018835 at 44 (Opinion entered February 19, 2021).

25 *Id*. at 48.

26 *Id*. at 51-52 (emphasis in original).

The COVID-19 Pandemic has clearly had a tremendous negative impact on the citizens and businesses of Pennsylvania. However, pursuant to the Commission's decision in *Columbia Gas*, the pandemic alone is not sufficient reason to outright deny PECO's request for rate relief. With that in mind, I have carefully examined the evidence and positions presented by PECO and the opposing parties with regard to PECO's cost of service and other ratemaking concerns raised using the traditional ratemaking methodologies. As a result of my examination, I have determined to recommend that the Company receive a reduced revenue increase of $23,892,217. The basis for this recommendation will be explained below.

B. <u>Rate Base</u>

As explained by I&E, rate base is the depreciated original cost of a utility's investment in plant a utility has in place to serve customers plus other additions and deductions that the Commission determines to be necessary in order to keep the utility operating and providing safe and reliable service to its customers.[27] Rate base includes all the utility's intangible assets (i.e., organization costs, franchise and consents costs, and land right costs) and tangible assets (i.e., facilities, equipment, and land) which have been depreciated over a period of time, or depreciated original cost plant in service, as well as the other allowed additions and deductions.[28] I&E MB at 12-13.

Additionally, the depreciated original cost is determined by subtracting the book reserve, which is the accumulation of all prior annual depreciation expense, and other items such as salvage value from the original cost of the plant in service that is projected to be used and useful in the public service.[29] The depreciated original cost of the plant in service is determined by taking a "snapshot" look at the depreciated original cost value of used and useful utility plant in service at the end of the fully projected future test year. I&E MB at 13.

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[27] I&E St. No. 3, p. 3.
[28] *Id.*
[29] *Id.*, p. 4.

PECO, I&E, and the OCA offered varying recommendations on the Company's rate base. OSBA, CAUSE-PA and PAIEUG did not take any positions on any rate base issues. PECO's, I&E's, and the OCA's recommendations will be summarized and reviewed below.

1. PECO's Position

a. Fair Value

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

PECO notes 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 on 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 below. PECO RB at 6.

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30 PECO St. 3, pp. 13-14 and PECO Ex. MJT-1 Revised, Sch. C-2.

b. Utility Plant in Service

i. The Company's Claim

PECO notes that the increase in its utility plant in service since its last gas base rate case in 2010 is the single largest factor driving the Company's need for an increase in revenues. PECO projects that it will need to invest approximately $1.2 billion in new or replacement gas utility plant between July 1, 2020 and June 30, 2024. The overwhelming portion of this investment is required to maintain the safety and reliability of PECO's gas distribution system, including accelerated main and services replacement, meter replacement, regulator replacements, mapping enhancements and security upgrades.[31] PECO MB at 14.

As previously noted, the Company's rate base claim in this case, as set forth in PECO Exhibit MJT-1 Revised, reflects its projection of the original cost of utility plant that will be in service as of June 30, 2022, and, therefore, includes the original cost of all plant additions and retirements forecasted to occur during the FPFTY. Accordingly, PECO's claims for FPFTY accumulated depreciation and annual depreciation expense are based on its projected plant balances as of June 30, 2022. PECO also projected the balance of its accumulated deferred income taxes (ADIT) and the regulatory liability for "excess" ADIT as of June 30, 2022, which are reflected in its rate base claim. In addition, PECO reflected an annual amount of plant-related tax deductions, which are included in PECO's calculation of its claimed income tax in this case.[32] PECO MB at 15.

Two issues have been presented related to PECO's investment in plant in service during the FPFTY. The OCA challenges PECO's budgeted data for FPFTY plant additions and proposes an allowance only at the Company's forecasted level of plant additions for the FTY, without an allowance for any plant additions during the FPFTY. Second, I&E witness Ethan H.

[31] *See* PECO St. 1, pp. 5-7, 10, 16-18; PECO St. 2, pp. 2-3.

[32] *See* PECO St. 3, pp. 13-15, 42-43; PECO St. 3-R, p. 5; PECO Ex. MJT-1 Revised, Schs. C-2, C-3, D-17 and D-18.

Cline proposes to reduce PECO's claimed plant in service balances for the Natural Gas Reliability project described in Mr. Bradley's direct testimony[33] to eliminate investments in gas utility plant that Mr. Cline believes will not be placed in service during the FPFTY. For the reasons discussed below, the OCA's and I&E's objections are without merit. PECO MB at 15.

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

OCA witness Lafayette K. Morgan proposed an adjustment to eliminate the entire allowance for plant additions totaling $305,555,000 that PECO projects will be placed in service in the FPFTY, with corresponding reductions to accumulated depreciation, ADIT and annual depreciation expense. The net effect of Mr. Morgan's adjustments would be to reduce PECO's rate base by approximately $271 million and to correspondingly reduce PECO's claim for depreciation expense by $7.827 million. Mr. Morgan offered two alleged bases for his proposed adjustments to reduce PECO's FPFTY rate base. First, he claimed that PECO's FPFTY projections are overstated and unreliable because they were based on an "abbreviated" budgeting process. Second, Mr. Morgan attempted to justify his entire proposed adjustment on the fact that certain PECO gas operations construction activities scheduled for the second quarter of 2020 were temporarily delayed as a result of the COVID-19 emergency.[34] PECO maintains that both of these arguments are wrong. PECO MB at 15-16; PECO RB at 7.

PECO asserts that Mr. Morgan is attempting to lend support to the OCA's untenable position that the Commission grant no rate increase in the first instance – a rejection of the Company's entire FTY and FPFTY claim for plant in service – or, in the alternative, reject the Company's entire FPFTY claim for plant in service. Contrary to Mr. Morgan's contention, the Company maintains that it employed a rigorous process to develop its FTY and FPFTY capital and operating budgets, consistent with the process reviewed by the Commission during its Focused Management and Operations Audit of PECO in 2014. As explained by PECO Witness Stefani, PECO's Senior Vice President, Chief Financial Officer and Treasurer, the Company utilizes a five-year Long Range Plan (LRP) that is regularly updated on a rolling basis. The

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33 PECO St. 1, p. 17.

34 *See* OCA St. 2, pp. 7-15; OCA St. 2-SR, pp. 2-10; OCA Sch. LKM-4.

budget process for this rate case began in June 2019 and concluded in August 2020. As explained by Mr. Stefani, the process started with the submission of LRPs by individual "responsibility areas," such as Gas Operations and Customer Operations, to PECO's finance group. The finance group then aggregated and analyzed the responsibility area LRPs and submitted them to PECO's senior management for review in September 2019. Following review, the LRP budget was approved by senior management in January 2020.[35] PECO MB at 16-17.

PECO notes that although this is where the budget process would typically end, PECO delayed the filing of this rate case due to the COVID-19 pandemic. As a result of the delay, in July 2020, the Company took the budget that was already approved by senior management in January 2020 for a March 2020 filing and refreshed it with the most up-to-date information to accommodate the use of a fiscal year ending in June – in other words, a historic test year ending June 30, 2020 – in order to align with the Company's delayed filing. The budget reflected the Company's current information regarding customer load, capital expenses, operating and maintenance (O&M) expenses, depreciation and amortization expense, and interest and tax expense. In addition, since this update occurred approximately four months into the COVID-19 emergency, the update reflected impacts resulting from the pandemic. The updated budget was finalized in August 2020.[36] As noted by Mr. Stefani, "the budget process utilized to develop the FTY and FPFTY cost of service was neither abbreviated nor independent of the Company's normal budget process."[37] Mr. Stefani also pointed out that the budget was fully reviewed and authorized by the Company's senior management.[38] PECO MB at 17.

In addition to incorrectly asserting that the budgeting process was abbreviated, Mr. Morgan contended that, because the Company developed its FTY and FPFTY budgets in the context of the COVID-19 pandemic, they are unreliable and unreasonable.[39] The development of FTY and FPFTY budgets is inherently an exercise in reasonable projections based on typical

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35 *See* PECO St. 2, pp. 10-12; PECO St. 2-R, p. 2; Hearing Tr. 249-51.
36 *See* PECO St. 2-R, pp. 2-3; Hearing Tr. 249-51.
37 PECO St. 2-R, p. 3.
38 Hearing Tr. 251.
39 OCA St. 2, pp. 4-6; OCA St. 2-SR, pp. 5-7.

and normal operating conditions and currently available information. PECO maintains that its FTY and FPFTY budgets reflect "the standard inputs to PECO's well-established gas forecasting process, including weather normalization based on 30-year averages, historical sales and customer growth trends, and economic forecasts provided by PECO's third-party vendor."[40] Moreover, the Company points to the Commission's recent decisions in *Columbia Gas* (pp. 52-53) and *PAWC* (pp. 45-46), noting that the proper course is to examine this data, and not to simply reject a requested rate increase due to the pandemic. PECO MB at 17-18.

PECO also believes that it is unreasonable to assume, as Mr. Morgan has, that the Company's FTY and FPFTY claims for plant in service are unachievable due to the COVID-19 pandemic. As both Messrs. Bradley and Stefani noted, some projects were delayed during the HTY, but PECO does not expect the in-service dates of any of the projects it expects to complete in the FTY or FPFTY to be delayed.[41] In addition, the Company's capital expenditures through 2020 demonstrate that the Company mitigated the delays caused by the COVID-19 pandemic. The Company spent approximately $274 million of its $277 million 2020 construction budget – approximately 99% of its target – and anticipates that it will be fully caught up on its construction budget by June 2021.[42] PECO MB at 18.

PECO maintains that Mr. Morgan conflated certain statements in PECO's testimony and discovery responses to arrive at the erroneous conclusion that the Company's claims are unreliable.[43] For example, Mr. Morgan compared PECO's responses to OCA-II-3(a) and OCA-XIII-3 and claimed that the differences between the "Estimated Completion Dates" provided in Attachment OCA-II-3(a) and the "Completion Dates" listed in the response to OCA-XIII-3 show that the Company's projected plant additions for the FTY and FPFTY are unreliable. Mr. Morgan's critique, however, appears to reflect a misunderstanding of the data provided by the Company and not inadequacies with the data itself. As explained by Mr. Stefani, OCA-II-3(a) requested PECO's capital budgets for the FTY and FPFTY. The broad spending categories and programs presented in the budget do not exactly align with the dollar

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40 PECO St. 2-R, p. 3.
41 PECO St. 1-R, pp. 3-4; Hearing Tr. 217-18, 246-47.
42 *Id.*
43 *See* OCA St. 2, pp. 6-9; OCA St. 2-SR, pp. 14-15.

amounts and completion dates presented in the Company's response to OCA-XIII-3(a), since OCA-XIII-3 is limited to the plant the Company anticipates will be placed into service in the FTY and FPFTY. The Company's broader capital budgets presented in its response to OCA-II-3 contain expenditures for plant that is aggregated as part of larger budget projects, which plant will be completed and placed into service prior to when the projects as a whole (and their associated capital expenditures) will be complete.[44] PECO MB at 18-19.

Mr. Morgan also contended that the Company's response to OCA-XIII-3, which stated that none of the projects anticipated to be completed and placed into service in the FTY and FPFTY would be delayed, was at odds with Mr. Bradley's acknowledgment that certain projects had been delayed in the HTY, and therefore, is further evidence that the Company's projected plant additions are unreliable.[45] PECO asserts that Mr. Morgan's contention is entirely refuted by Mr. Bradley's and Mr. Stefani's testimony demonstrating that the Company has already almost entirely caught-up from those delays, and none of its FTY or FPFTY in-service dates have been delayed.[46] PECO MB at 19.

In summary, Mr. Morgan's conclusion that the Company's FPFTY plant in service projections are unreliable is unsupported and contrary to the substantial evidence presented by the Company. The Commission should reject Mr. Morgan's proposed adjustment to the Company's plant in service claim. PECO MB at 19.

iii. 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. PECO notes that I&E witness Cline also took issue with PECO's FPFTY claim for plant additions and recommended an adjustment to reduce PECO's forecasted plant-in-service balances for the Natural Gas Reliability project by $47,624,803. Mr. Cline contends that PECO's claimed plant additions associated with this

44 PECO St. 2-R, pp. 5-7; Hearing Tr. 244-47.
45 OCA St. 2, pp. 14-15; OCA St. 2-SR, pp. 3-5.
46 Hearing Tr. 217-18 and 246-47.

project are higher than the plant additions placed in service, or to be placed in service, in the FPFTY that he calculated based on data regarding the Company's total investment to date and anticipated completion date identified in PECO's response to Interrogatory I&E-RB-4-D.[47] More specifically, 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.[48] PECO MB at 19-20; PECO RB at 11.

As Mr. Bradley explained, the Company's Natural Gas Reliability project consists of three components: (1) the installation of 11.5 miles of gas main; (2) capital upgrades to the Company's West Conshohocken liquified natural gas (LNG) facility; and (3) the construction of a new gate station, or reliability station. Mr. Cline mistakenly treated the three components of the Natural Gas Reliability project as a single, linear project. In fact, the three components will be constructed, placed into service, and will be able to provide service to customers independently. The new 11.5-mile gas main and new reliability station are scheduled to be in-service and will be used to provide natural gas service to PECO customers by the second quarter of 2022 (i.e., during the FPFTY). While the planned upgrades to the LNG facility will not be completed and placed into service until the end of 2022 (i.e., after the end of the FPFTY), the associated costs of those upgrades are not reflected in the Company's FPFTY claim for plant additions.[49] PECO MB at 20; PECO RB at 11.

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

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[47] *See* I&E St. 3, pp. 10-12; I&E St. 3-SR, pp. 4-6; I&E Ex. No. 3, Sch. 2.
[48] I&E M.B., pp. 15-17.
[49] PECO St. 1-R, pp. 18-20; Hearing Tr. 213-17.

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. PECO MB at 20; PECO RB at 12-13.

c. Depreciation Reserve

PECO's annual depreciation accrual applicable to plant in service on June 30, 2022 is $892,383,000.[50] The annual accrual is based upon a detailed depreciation study sponsored by PECO witness Caroline Fulginiti.[51] No party has contested the service lives or depreciation calculations prepared by Ms. Fulginiti. PECO MB at 21.

I&E witness Mr. Cline proposed an adjustment to reduce accumulated depreciation by $804,000.[52] However, this adjustment is concomitant to the adjustment he proposed to the Company's claimed level of plant additions for the Natural Gas Reliability Project. If I&E's proposed adjustment to reduce PECO's FPFTY plant in service balances for the Natural Gas Reliability project from $82,481,428 to $34,856,625 is not adopted, no concomitant rate base adjustment would be necessary. PECO MB at 21.

OCA witness Morgan also challenged PECO's FPFTY plant additions claim, which adjustment carried with it a related disallowance of the Company's depreciation accrual in the amount of ($41,453,000).[53] However, for the reasons discussed previously, PECO argued that the OCA's underlying plant additions adjustment should not be adopted. PECO MB at 21.

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50 PECO Ex. MJT-1 Revised, Sch. C-2.
51 *See* PECO St. 4, pp. 7-11; PECO Ex. CF-3.
52 I&E St. 3, pp. 14-16.
53 *See* OCA Sch. LKM-4, p. 2.

d. Additions to Rate Base

i. Projected Plant Additions

PECO notes that it previously addressed projected plant additions in its general discussion of utility plant in service. However, PECO also notes that 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 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.[54] The OCA's and I&E's objections are without merit and should be rejected. PECO MB at 21; PECO RB at 7.

ii. Pension Asset

PECO notes that the pension asset arises because of a difference in the calculation of pension costs for ratemaking purposes in Pennsylvania and the calculation of pension costs under GAAP. The Commission has generally required that pension costs for ratemaking purposes should be based upon a utility's cash contribution to its pension fund, while GAAP requires pension costs to be determined on the basis of different rules, which are set forth in the Statement of Financial Accounting Standards No. 87 (SFAS 87). Use of these two different procedures results in an annual difference between the amount of pension costs recovered in rates established by the Commission (based on cash contributions) and the amount of pension costs reflected on the accounting records of the Company (based on SFAS 87).[55] PECO MB at 22.

The pension asset represents the accumulated amount of the difference related to the portion of the pension costs that are capitalized and included in utility plant accounts. PECO

[54] PECO St. 1, p. 17.
[55] PECO St. 3-R, p. 10.

must capitalize and include in its plant accounts an amount that is based on pension costs calculated on the basis of SFAS 87. This means that the amounts that are assumed for ratemaking to be included in PECO's plant accounts (based on the application of a capitalization rate to the cash pension contribution) necessarily differ from the amounts that are actually capitalized by PECO by applying, as it must, GAAP rules.[56] PECO MB at 22.

The pension asset reflects the difference between: (1) the amount of pension cost the Commission's assumes was included in PECO's plant accounts; and (2) the amount of pension costs actually included in PECO's plant accounts. That difference is $35.1 million. The pension asset, therefore, consists of $35.1 million of investor-supplied capital that was actually contributed to PECO's pension fund and assumed for ratemaking purposes to be included in PECO's plant accounts, but was not recorded in PECO's plant accounts because GAAP rules will not allow it. PECO has included the pension asset in rate base in this case because, unless it is given rate base recognition, PECO will never recover the carrying costs it incurs on those investor-supplied funds. PECO is only proposing to include the pension asset in rate base to recover the associated carrying costs on a prospective basis and is not seeking to recover prior carrying costs in this case.[57] PECO MB at 22-23; PECO RB at 13.

There is no disagreement with respect to the fact that there is a difference between what the Commission requires for ratemaking purposes and GAAP rules.[58] Nevertheless, both I&E witness D.C. Patel and OCA witness Morgan object to the Company's claim. Mr. Patel asserts that the claim should be disallowed because PECO is undertaking a "switch" in the methodology by which it accounts for the pension asset, and that PECO is earning a return over time on its contribution.[59] For his part, Mr. Morgan contends that no part of PECO's contributions to its pension funds should be capitalized, that PECO is recovering its contributions through base rates, and inclusion of the pension asset would overstate rate base since it is not amortized.[60] PECO MB at 23.

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56 *Id.*, p. 11.
57 *Id.*, pp. 11-12.
58 *Id.*, p. 12; I&E St. 1, p. 47; OCA St. 2, pp. 15-16.
59 I&E St. 1, p. 47.
60 OCA St. 2, pp. 15-19.

As. Mr. Trzaska explained, each of these contentions is flawed. PECO is not "switching" its methodology with respect to the pension asset, and the return on PECO's contribution to its pension funds remain entirely with the funds – it does not accrue to PECO or compensate PECO in any way for its actual contribution.[61] With respect to capitalization, the difference between the pension contribution and other employee costs that are capitalized arises due to the accounting treatment creating a gap between the pension cost excluded from operating expenses and the cost included in plant in service – which will be unrecognized unless the pension asset is included in rate base.[62] PECO's total pension contribution is also reduced by a capitalization rate and only the remaining uncapitalized portion is charged to operating expense, and therefore there is no over-recovery. Furthermore, there is no over-statement of rate base: the pension asset is not amortized, and PECO recovers only a return on the actual, unamortized balance (which can be debited or credited each year depending on pension costs).[63] PECO MB at 23-24.

Notably, the Commission has previously approved three settlements of rate case proceedings for Duquesne Light in which the settling parties agreed to a rate base adjustment for pensions consistent with PECO's approach.[64] While PECO recognizes the limited precedential nature of settlements, the fact remains that the Commission has previously and repeatedly approved an adjustment to rate base that recognizes the pension asset as PECO has proposed. The pension asset-related adjustments to rate base offered by OCA and I&E should be rejected. PECO MB at 24.

PECO believes that it 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

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61 PECO St. 3-R, p. 19.
62 *Id.*, p. 17.
63 *Id.*, pp. 17-18.
64 *See* PECO St. 3-R, pp. 13-15.

consistent with PECO's claim in this proceeding.[65] As previously noted, PECO recognizes the limited precedential nature of settlements. However, just as non-precedential opinions of Pennsylvania courts may properly be cited and relied upon for their logic and persuasive value,[66] 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.[67] 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. PECO RB at 15-16.

PECO maintains that, 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. PECO RB at 16.

iii. Uncontested Items

1. Cash Working Capital

Cash working capital represents the funds needed to pay O&M expenses and taxes that, on average, are incurred in advance of the utility's receipt of revenues. PECO calculated its cash working capital requirement using the accepted, PUC-approved lead-lag method.[68] No party disputed the methodology that the Company employed or challenged its proposed revenue lag, expense lag or net lag (revenue lag minus expense lag). However, O&M expenses are an input to the calculation of cash working capital. For that reason, I&E and the

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[65] *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").

[66] *See* Pa.R.A.P. 126(b).

[67] *See* PECO St. 3-R, pp. 12-15.

[68] PECO St. 3, pp. 16-22; PECO Ex. MJT-1 Revised, Sch. C-4.

OCA, which have both proposed adjustments to PECO's expense claims, have also calculated different cash working capital allowances. PECO's arguments regarding these O&M expense adjustments will appear under the "Expenses" portion of this decision, where the Company explains why it believes neither Mr. Patel's nor Mr. Morgan's various adjustments should be adopted. Nonetheless, the Company posits that if any changes are made to the Company's proposed O&M expenses, its cash working capital would need to be recalculated. PECO MB at 24-25.

2. Other Non-Contested Rate Base Additions

The Company's rate base claim includes an amount of $31.6 million representing its investment in materials and supplies and gas storage inventory. That amount is the average of PECO's monthly account balances for both items for the thirteen months ended September 30, 2020.[69] PECO maintains that no party disagrees with the Company's updated claims for these rate base additions to reflect the most recent thirteen-month historic averages and derivative changes in cash working capital attributable to those updates. PECO MB at 25.

2. I&E's Position

a. Fair Value

I&E notes that The Company's total revised rate base claim for the FPTY ending June 30, 2021, is $2,463,555,000.[70] The Company's revised rate base claim is based on the acceptance of certain rate base adjustments recommended by I&E witness Cline as well as those of OCA witness Morgan.[71] I&E further notes, however, that it still does not accept the Company's revised claim as it only accepted some of I&E's recommendations.[72] Specifically, the Company accepted the adjustments I&E made to gas storage inventory, materials and

69 PECO St. 3-R, pp. 2-3; PECO Ex. MJT-1 Revised, Schs. C-11 and C-13.
70 *See* PECO Exh. MJT-1 Rev., Sch. A-1.
71 *See* I&E St. No. 3-SR, p. 3. See also PECO St. No. 3-R, p. 3.
72 I&E St. No. 3-SR, p. 3.

supplies, customer deposits, and customer advances.[73] However, I&E continues to assert support for its remaining recommendations regarding the Company's plant additions and accrued depreciation claims.[74] I&E MB at 13-14; I&E RB at 8.

b. Utility Plant in Service

Utility plant-in-service, or rate base, includes all the utility's intangible assets (i.e., organization costs, franchise and consents costs, and land right costs) and tangible assets (i.e., facilities, equipment, and land) which have been depreciated over a period of time, or depreciated original cost plant in service, as well as the other allowed additions and deductions.[75] Moreover, for a utility plant to be included in rates, the plant must be used and useful in the provision of utility service to the customers. Therefore, by definition, only plant currently providing or capable of providing utility service to customers or plant projected to be completed and in service by the end of the FPFTY is eligible to be reflected in rates.[76] I&E MB at 14.

c. Depreciation Reserve

I&E recommends that the overall accumulated depreciation should be decreased by approximately $804,000.[77] The $804,000 decrease corresponds with the I&E recommendation to remove a portion of the Natural Gas Reliability project plant addition as argued *infra*.[78] I&E recognizes that it's adjustment to annual depreciation expense is contingent upon I&E's adjustment to plant additions.[79] And, because I&E is continuing to recommend the adjustment to plant additions, discussed above, I&E is therefore continuing to recommend the Company's annual depreciation expense claim be decreased by approximately $804,000.[80] I&E MB at 14-15.

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73 *Id.*
74 *Id.*
75 I&E St. No. 3, p. 3.
76 I&E St. No. 3, p. 8.
77 I&E St. No. 3, p. 13; I&E St. No. 3-SR, pp. 6-7.
78 *Id.*
79 I&E St. No. 3-SR, p. 8.
80 *Id.*

Regarding accumulated depreciation, and to remain consistent with the plant in service and annual depreciation expense adjustments, I&E recommends the accumulated depreciation claim be reduced by approximately $804,000 from $892,383,000 to $891,579,000 which are also contingent upon I&E's adjustments to the plant in service.[81] I&E MB at 15.

I&E notes PECO's argument that I&E's adjustment to reduce accumulated depreciation by $804,000 is concomitant to the adjustment I&E proposed to the Company's claimed level of plant additions for the Natural Gas Reliability Project,[82] and that the Company also argued that if I&E's proposed adjustment to reduce PECO's FPFTY plant in service balances for the Natural Gas Reliability project is not adopted, then no concomitant rate base adjustment would be necessary.[83] I&E disagrees and continues to recommend the adjustment to plant additions previously discussed, that the Company's overall accumulated depreciation claim be decreased by approximately $804,000.[84] I&E RB at 9.

d. Additions to Rate Base

i. Projected Plant Additions

I&E recommends the disallowance of $47,624,803 of the projected $82,481,428 in claimed plant additions for the "Natural Gas Reliability - Install 11.5 miles of OHP gas main, upgrade LNG plant and construct a new gate station" project[85] which results in the claimed $82,481,428 being reduced to $34,856,625.[86] I&E MB at 15.

The Company argued the "Natural Gas Reliability project consists of three components (1) upgrades to the West Conshohocken LNG facility; (2) the construction of a new 11.5-mile gas main and (3) a new reliability station."[87] PECO further claimed that

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81 I&E St. No. 3, p. 15; I&E St. No. 3-SR, p. 9.
82 PECO MB, p. 21.
83 *Id.*
84 I&E MB, p. 15.
85 I&E St. No. 3, p. 10. *See also*, I&E Exhibit No. 3, Sch. 2, p. 3 of 3.
86 *Id.*
87 PECO St. No. 1-R, pp. 18-20.

approximately 50% of the aggregate costs will be spent in 2021, the new reliability station and 11.5-mile gas main are scheduled to be in service by the end of the FPFTY, and that the entirety of the Natural Gas Reliability project is scheduled to be in service by the end of 2022.[88] PECO, however, has provided conflicting information regarding the completion and in-service dates for these projects. I&E MB at 15-16; PECO RB at 10-11.

I&E notes that the Company's rebuttal testimony is not consistent with responses it provided to I&E. PECO's statement that the entirety of the project is scheduled to be in service by the end of 2022 is not consistent with the in-service date of June 2023 provided in the Company's response to I&E-RB-4-D.[89] The Company provided no evidence or support for its updated claim of the end of 2022 for its in-service date for the Natural Gas Reliability project.[90] Additionally, as the FPFTY ends June 30, 2022, the Company's projection of end of 2022 for the in-service date necessarily means that the project will not be fully in-service within the FPFTY.[91] Finally, the Company's attempt to "correct" its testimony through oral rejoinder suffers from the same inconsistencies. The time to provide the Commission the complete and correct justification is in the Company's case-in-chief in the filing, which is the purpose of the Public Utility Code requirements and the Commission's regulations regarding general rate increase filings in excess of $1 million. I&E MB at 16.

PECO argued that I&E witness Cline mistakenly treated the three components of the Natural Gas Reliability project as a single, linear project,[92] when, in fact, the three components will be constructed, placed into service, and will be able to provide service to customers independently.[93] PECO's explanation included a long discussion of PECO's laddered budgeting process and how they eventually arrived at their projections.[94] But, PECO's explanation does not cure the questions I&E had from the start as I&E explained in its main

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88 *Id.*
89 I&E St. No. 3-SR, p. 5, *citing* I&E Exh. No. 3, Sch. 2, p. 3.
90 I&E St. No. 3-SR, p. 6.
91 *Id.*
92 PECO MB, p. 20.
93 PECO MB, p. 20.
94 *Id.*, pp. 16-19 (responding to OCA witness Morgan).

brief.[95] I&E sought clarity on this issue from the start and PECO's responses changed throughout the litigation process. I&E RB at 10.

Therefore, I&E recommends the Commission accept I&E's calculation that the Natural Gas Reliability project is 28% completed with $33,888,385 spent to date.[96] Dividing the $33,888,385 by 28% indicates that the total project cost is $121,029,946. Therefore, the remaining cost of the project is $87,141,561 ($121,029,946 – $33,888,385).[97] The Company further listed the completion date of this project as June 2023, or approximately 2.5 years remaining to complete the project.[98] Therefore, the Company is projecting it will spend $87,141,561 over 2.5 years, or, on a linear basis, $34,856,625 per year ($87,141,561 / 2.5 years). As the Company is unlikely to spend 94.6% of the remaining project costs in the FPFTY ($82,481,428 / $87,141.561 x 100%), I&E recommends an allowance of the linearly determined remaining cost share in the FPFTY, or $34,856,625.[99] Therefore, I&E recommends that the Company's claim for plant additions in the FPFTY be reduced by $47,624,803 from $82,481,428 to $34,856,625.[100] I&E MB at 16-17; I&E RB at 11.

ii. Pension Asset

I&E recommended disallowance of the Company's $35,059,000 claim or a reduction of $35,059,000 to the Company's rate base claim.[101] The pension asset represents a mismatch from a GAAP accounting perspective (use of an accrual method for plant accounts) and a cash contribution method for the expense account in ratemaking, and these differences between GAAP expense and cash contributions in any given year should not be viewed as a valid reason to inflate the plant amounts in rate base. Therefore, for ratemaking purposes the Commission should disallow this claim.[102] I&E MB at 17.

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95 I&E MB, pp. 15-17.
96 I&E St. No. 3, pp. 11-12, *citing* I&E Exh. No. 3, Sch. 2, p. 3 of 3.
97 *Id.*
98 *Id.*
99 *Id.*
100 I&E St. No. 3-SR, p. 6.
101 I&E St. No. 1, p. 47.
102 *See* I&E St. No. 1, pp. 47-50; I&E St. No. 1-SR, pp. 41-43.

This issue arose because PECO included a $35,059,000 pension asset in rate base that consists of the portion of PECO's cash pension contributions that PECO argues it will have neither recovered as an operating expense nor capitalized to utility plant because the capitalized amounts are based on costs determined pursuant to Financial Accounting Standards Codification Topic 715 or (ASC 715), which was formerly Statement of Financial Accounting Standards 87 or (SFAS 87).[103] I&E MB at 18.

The Company argues the pension asset of $35.1 million is 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 to recover the previously unrecovered associated carrying cost and PECO is not seeking their recovery in this case.[104] But, I&E disagrees and asserts that the pension asset of $35.1 million should not be included in PECO's plant accounts to recover the previously unrecovered associated carrying cost.[105] Rather, fundamentally, the pension asset is created due to mismatch in GAAP accounting and ratemaking treatment of pension costs (an accounting journal entry), and there is no real infusion of capital or funds by the investors/stockholders that is eligible for return on investment.[106] Additionally, the accumulated balance of the pension asset should not be categorized or described as a utility asset that is used and useful in providing utility services to ratepayers, and therefore, should not be included as an eligible asset in the rate base claim to recover the associated carrying cost (earning a return on it).[107] I&E MB at 18; I&E RB at 12-13.

The Company also argues that the Commission's method to reflect pension costs in operating expenses for ratemaking purposes causes a real and material difference between the amounts the Commission assumes will be capitalized (based on cash pension contributions) and the amounts that are actually capitalized (based on GAAP rules that public companies follow).[108] But this argument is just an acknowledgment of the fact that the pension asset represents a

[103] PECO St. No. 3, pp. 5-6.
[104] PECO St. No. 3-R, pp. 11-12.
[105] I&E St. No. 1-SR, p. 41.
[106] I&E St. No. 1-SR, pp. 41-42.
[107] I&E St. No. 1, pp. 47-48.
[108] PECO St. No. 3-R, p. 12.

mismatch in GAAP accounting and ratemaking treatment of the pension costs.[109] I&E MB at 19.

PECO also argues that the conceptual basis for including a pension asset in rate base was adopted and affirmed in the black-box settlements of three consecutive rate cases of Duquesne Light Company (Duquesne) filed in 2010, 2013, and 2018 and I&E did not appear to oppose this.[110] "Black box" settlements allow the parties to reach an amicable agreement which is by definition a negotiated compromise on the part of all parties and does not necessarily represent the positions the parties would have adopted during litigation.[111] The purpose is to avoid the expense of litigation and at the same time preserve all arguments raised during the litigation for future litigation if the parties ever deem it necessary to litigate a contested issue. I&E MB at 19; I&E RB at 13.

Finally, the Company argues the calculation of the pension asset is not a one-way street.[112] PECO added that the pension fund contributions used to calculate pension expense for ratemaking have thus far been more than the pension accruals under SFAS 87, used to calculate the amount of pension costs included in plant accounts.[113] However, that relationship could change over time, and if that occurs, PECO will reflect the net cumulative pension liability as a reduction to rate base for ratemaking purposes.[114] Nevertheless, I&E asserts that it is I&E's understanding that over time, differential amounts (positive/negative) between the sum amount recorded for accrual accounting purposes per GAAP and the sum amount of annual cash contributions shall match or change to a liability account.[115] Therefore, these differences between GAAP expense and cash contributions in any given year should not be viewed as a valid reason to inflate the plant amounts in rate base. I&E MB at 19-20; I&E RB at 13-14.

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[109] I&E St. No. 1, p. 47.
[110] PECO St. No. 3-R, pp. 19-20.
[111] I&E St. No. 1-SR, p. 43.
[112] PECO St. No. 3-R, p. 19.
[113] *Id.*
[114] PECO St. No. 3-SR, pp. 19-10.
[115] I&E St. No. 1, p. 49; I&E St. No. 1-SR, p. 43.

Therefore, in consideration of all of the above and the record evidence presented by I&E, I&E recommends the disallowance of the Company's $35,059,000 pension asset claim and a reduction of $35,059,000 to the Company's rate base claim.[116] I&E MB at 20.

iii. Uncontested Items

I&E recommended that the Company's materials and supplies, gas in storage, customer deposits, and customer advances for construction claims in the FPFTY be determined using an updated thirteen-month average ended September 2020 as shown on I&E Exhibit No. 3, Schedule 1.[117] The Company did not object to updating these claims to reflect data for the 13-months ended September 30, 2020.[118] I&E MB at 20.

Additionally, I&E recommended that the Company provide the Commission's Bureaus of Technical Utility Services and Investigation and Enforcement with an update to PECO Exhibits MJT-1 and MJT-2, Schedule C-2, no later than October 31, 2021, which should include actual capital expenditures, plant additions, and retirements by month from July 1, 2020, through June 30, 2021.[119] I&E also recommended an additional update be provided comparing projected additions and retirements with actual additions and retirements through June 30, 2022, no later than October 1, 2022.[120] And, the Company agreed with the I&E recommendation regarding the FPFTY reporting requirements.[121] I&E MB at 21; I&E RB at 14.

I&E notes, however, that the Company included its cash working capital methodology as an uncontested item.[122] But, as the Company points out, I&E made an expense adjustment to cash working capital that I&E addressed in the corresponding expense section of its main brief[123] and which PECO disputes.[124] I&E RB at 14.

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116 I&E St. No. 1-SR, p. 43.
117 I&E St. No. 3, pp. 16-18, 20-21, *citing* I&E Exh. No. 3, Sch. 1.
118 PECO St. No. 3-R, pp. 2-3, *citing* PECO Exh. MJT-1 Rev. Sch. C-4 thru C-13.
119 I&E St. No. 3, pp. 8-9.
120 *Id.*
121 PECO St. No. 3-R, p. 10.
122 PECO MB, pp. 24-25.
123 I&E MB, p. 50.
124 PECO MB., p. 25.

3. OCA's Position

a. Fair Value

The OCA did not brief this specific issue.

b. Utility Plant in Service

In this proceeding, the Company's claim for utility plant in service is approximately $3.5 billion for the FPFTY ended June 30, 2022.[125] This number is derived, in part, from the Company's estimated plant additions of $322.1 million during the FPFTY.[126] OCA witness Lafayette K. Morgan explained that, after multiple requests for the necessary data from the Company, he was unable to access the detailed data supporting the Company's plant in service claim.[127] The information Mr. Morgan did receive contained inconsistencies and, therefore, Mr. Morgan was left without a high degree of confidence that the Company's plant in service data was reliable and accurate.[128] As a result, Mr. Morgan adjusted the plant-related components in rate base to reflect the FTY level of additions.[129] The adjustment resulted in a decrease to the Company's net plant in service of approximately $271 million as presented on Schedule LKM-2, page 1. The OCA recommends that the Commission adopt the recommendation of OCA witness Morgan and remove the Company's projected plant additions for the FPFTY. OCA MB at 31.

c. Depreciation Reserve

The only OCA adjustment to the Company's depreciation reserve is a derivative adjustment relating to Mr. Morgan's plant in service adjustment discussed below. In other words, the accumulated depreciation amount should reflect the FTY amount, rather than the

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125 *See* PECO St. 3-R, Exh. MJT-1 Revised, Schedule C-2, page 15, column 4, line 35.
126 *See* PECO St. 3-R, Exh. MJT-1 Revised, Schedule C-2, page 16, line 32.
127 *See e.g.* OCA St. 2 at 14.
128 *Id*.
129 *Id*.

FPFTY amount, which is consistent with Mr. Morgan's Plant in Service Adjustment.[130] The reduction of $271 million to the Company's net plant in service as reflected on Schedule LKM-2, page 1, incorporates the removal of $41.5 million from its accumulated depreciation balance.[131] OCA MB at 32.

d. Additions to Rate Base

i. Projected Plant in Service

In this proceeding, the Company used a FPFTY ended June 30, 2022, and projected substantial capital additions for FTY and FPFTY.[132] More specifically, for the FTY ended June 30, 2021, the Company is projecting approximately $292 million in plant additions bringing its total plant in service claim to approximately $3.232 billion.[133] For the FPFTY ended June 30, 2022, the Company is projecting approximately $322 million in plant additions bringing the Company's total plant in service claim to approximately $3.538 billion.[134] OCA MB at 32.

During OCA witness Morgan's investigation of the Company's plant addition claims, he made repeated efforts to obtain the information supporting the Company's FTY and FPFTY plant additions. However, when he requested specific budgeting data, broken out by plant account, the data could not be produced except at a high-summary level. Moreover, the data that was provided included projects with an end date that extended well beyond the FPFTY.[135] OCA MB at 32-33.

In addition to the lack of specific and conflicting budget data, Mr. Morgan identified some additional concerns related to the Company's budgeting process. In essence, the Company developed a five-year long-range plan (LRP) in June 2019 that was completed in

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130 *See* OCA St. 2-SR, Sch. LKM-2, Pg. 1.
131 *See* OCA St. 2-SR, Sch. LKM-2, Pg. 1, Line 2.
132 *See* PECO St. 3, Sch. MJT-1, Sch. C-2, Line 32; see also PECO St. 3, Sch. MJT-2, Sch. C-2, Line 32.
133 *See* PECO St. 3, Sch. MJT-1, Sch. C-1, Column 4, Line 1.
134 *See* PECO St. 3, Sch. MJT-1, Sch. C-1, Column 4, Line 1.
135 *See* OCA St. 2, App. B at 31.

January 2020, well before the onset of the COVID-19 Pandemic.[136] As noted by Mr. Morgan, if the LRP was developed prior to the COVID-19 Pandemic, this calls into question the projected plant additions. Moreover, after the LRP was developed without taking into account the effects of the COVID-19 Pandemic, the Company then developed its FTY and FPFTY budgets over a two-month period in the summer of 2020.[137] As Mr. Morgan testified, this raised several concerns. First, no indication was made by the Company that the test year budgets were reflected to account for the effects of the COVID-19 Pandemic.[138] Furthermore, this abbreviated approach to developing a test year budget during a period of great economic volatility creates concern for the accuracy of these projections. The Company also did not provide any of the specific instructions or guidance relied upon when developing this test year budget.[139] OCA MB at 33-34.

OCA also found it concerning that the Company acknowledged that the COVID-19 Pandemic had impacted the Company's planned FTY plant additions, but that it would not impact the Company's FPFTY projections. Accordingly, Mr. Morgan did not have a high degree of confidence in the Company's forward-looking estimates. OCA MB at 35.

For these reasons, Mr. Morgan recommends that, rather than rely on the Company's planned additions for FPFTY, the Commission rely upon the FTY plant additions, which is a reasonable compromise given the lack of clarity associated with the Company's projections.[140] This adjustment is similar to the Commission's decision regarding the general rate increase request of Columbia Gas of Pennsylvania, Inc. (*Columbia Gas*), where the Commission removed $71 million in FPFTY plant additions because Columbia Gas failed to provide substantial evidence to validate its FPFTY plant additions.[141] As stated by the Commission:

> We find persuasive the OCA's argument, and the ALJ's finding, that [Columbia Gas] failed to provide substantial evidence to

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136 *See* OCA St. 2 at 8-9; *see also* OCA St. 2, App. B at 28.
137 *See* OCA St. 2, App. B at 28.
138 *See* OCA St. 2 at 4-5; *see also* PECO St. 2-R at 3.
139 *See* OCA St. 2 at 4.
140 OCA St. 2 at 15.
141 *See Columbia Gas* at 61.

> adequately validate the [Columbia Gas'] FPFTY plant additions for the FPFTY; while the OCA's adjustment was based on actual historical data. This is consistent with our discussion above under the first issue – determining net plant additions in the FPFTY is a matter of judgement for the Commission, governed by the evidence presented in this record and guided by our regulatory expertise.

Id. OCA MB at 35-36.

Similarly, PECO is projecting $614 million in plant additions across both its FTY and FPFTY[142] based upon a LRP that was prepared before the pandemic began,[143] has not been updated to reflect the impacts of the COVID-19 Pandemic,[144] and is supported by inconsistent and vague data reflecting some projects that extend beyond the end of the test year.[145] The Company has the burden of proof to demonstrate by a preponderance of the evidence that these additions will be placed into service as projected and it has not met that burden.[146] OCA MB at 36.

In response to the adjustment recommended by Mr. Morgan, Company witness Bradley continues to assert that there will be no delays to the projected plant in service for the FPFTY.[147] As Mr. Morgan testified, however, this may not be entirely accurate as a large portion of the future plant additions are based upon new connections within the Company's service territory, which may be greatly affected with the COVID-19 Pandemic.[148] Moreover, during the evidentiary hearing, Mr. Bradley testified that bare steel replacements have been rescheduled and postponed due to the COVID-19 Pandemic.[149] Bare steel replacements, however, are included in the Company's projected FTY and FPFTY plant additions.[150] Accordingly, the OCA maintains that it is unclear based on Mr. Bradley's statements whether these projects will be affected as well. OCA MB at 36-37.

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142 PECO St. 3, Sch. MJT-1, Sch. C-2, Line 32; *see also* PECO St. 3, Sch. MJT-2, Sch. C-2, Line 32.
143 *See* OCA St. 2, App. B at 28.
144 *See* PECO St. 2-R at 3.
145 *See* OCA St. 2 at 10-11; *see also* OCA St. 2, App. B at 31.
146 *See* 66 Pa. C.S. § 315(e).
147 PECO St. 1-R at 4.
148 OCA St. 2-SR at 6.
149 Tr. at 213.
150 Tr. at 258-59.

The OCA submits that the Company's planned plant additions for the FPFTY are not supported by sufficient evidence. As the Commission stated "determining net plant additions in the FPFTY is a matter of judgement for the Commission, governed by the evidence presented in this record and guided by our regulatory expertise."[151] Similar to the Commission's decision to reduce Columbia Gas of Pennsylvania Inc.'s (*Columbia Gas*) claimed FPFTY plant additions in the recent *Columbia Gas* decision, the Company has failed to adequately demonstrate that its FPFTY plant additions are based upon sufficient evidence.[152] For these reasons, the Commission should accept the adjustment of OCA witness Morgan and reduce the Company's net plant in service claim by approximately $271 million.[153] OCA MB at 37; OCA RB at 14-15.

ii. Pension Asset

The Company is seeking to include in rate base a 'Pension Asset,' which represents the accumulation of past differences between the portion of pension expense that the Company assumes to be capitalized for ratemaking purposes and what is actually capitalized for financial accounting purposes.[154] In other words, the Company is seeking to earn a return on past pension expense that has yet to be capitalized for financial accounting purposes.[155] The OCA submits that the Company's claim should be denied. As the Pension Asset is composed of past pension expense that has not yet been capitalized and cannot be included in the Company's capital accounts for some time, it cannot be included within the Company's rate base. The Pension Asset, however, will be included in rate base in future years when it is appropriate to do so for financial accounting purposes. Accordingly, the Commission should deny the Company's claim and reduce the Company's rate base by $35,059,000.[156] OCA MB at 37-38.

As stated in the Direct Testimony of PECO witness Trzaska, the Company has included a Pension Asset of approximately $35.1 million in measures of value for determining

151 *Columbia Gas* at 61.
152 *Columbia Gas* at 61-62.
153 OCA St. 2-SR, Sch. LKM-2, Pg. 2, Line 5.
154 PECO St. 3 at 22-23.
155 *See also* I&E St. 1 at 47.
156 OCA St. 2 at 19; *see also* OCA St. 2-SR, Sch. 5.

the Company's rate base in this proceeding.[157] The Pension asset represents the difference between the portion of pension expense that it assumes to be capitalized for ratemaking purposes and what is actually capitalized and included in the Company's plant accounts for financial accounting purposes.[158] OCA MB at 38.

More specifically, the Company makes an annual cash contribution to its pension plan in accordance with federal requirements (Cash Contribution).[159] The Cash Contribution is what the Company uses for ratemaking purposes when determining the amount of pension expense properly included in rates.[160] Thus, as demonstrated by Exh. MJT-1 Revised, a portion of the Company's cash contribution is expensed and a portion must be capitalized.[161] In this case, the Company is *assumed* to have capitalized approximately $1.8 million for its gas operations.[162] The rest is expensed and claimed for ratemaking purposes.[163] OCA MB at 38.

Separate and apart from this Cash Contribution, the Company, in accordance with financial accounting requirements, has an annual required contribution amount calculated by an actuary, which uses an accrual basis method of accounting (ASC 715).[164] This ASC 715 amount may be larger or smaller than the Company's Cash Contribution, but has generally been lower for PECO in previous years.[165] The Company uses this amount to determine what it will capitalize to the Company's capital accounts. That is, the Company capitalizes a portion of the ASC 715 amount, rather than the Cash Contribution amount.[166] Thus, there is a mismatch for accounting and ratemaking purposes that results in cumulative differences in accounting.[167] The Pension Asset represents those cumulative differences and is presently at approximately $35.1 million, as calculated by the Company. OCA MB at 39.

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157 PECO St. 3 at 22.; *see also* PECO St. 3, Sch. MJT-1, Sch. C-1, Column 4, Line 7.
158 PECO St 3 at 22-23.
159 OCA St. 2 at 16.
160 OCA St. 2 at 17; *see also* PECO St. 3 at 23.
161 *See* PECO St. 3-R, Exh. MJT-1 Revised, Sch. D-9.
162 *Id.*
163 *Id.*
164 OCA St. 2 at 17.
165 OCA St. 2 at 17.
166 PECO St. 1 at 23.
167 I&E St. 1 at 47.

As further explained by Mr. Morgan, this gap in financial accounting is booked to the Company's Account 186 – Miscellaneous Deferred Debits.[168] It is important to note that this is not a capital investment account, but is rather a deferred debit, or current asset.[169] Current assets are not generally included in a Company's rate base measures of value.[170] Moreover, as Mr. Morgan explains, the Pension Asset will remain on the Company's books and will not be amortized until the ASC 715 amount exceeds the Company's Cash Contribution.[171] OCA MB at 39-40.

Based on the nature of this claim, the OCA submits that the Commission should deny the Company's request to include the Pension Asset in rate base. Including the Pension Asset in rate base would inappropriately allow the Company to earn a return on unamortized pension expense, which the Commission has disallowed in the past.[172] Moreover, because the amounts currently reflected in the Pension Asset have not yet been capitalized for financial accounting purposes, and may not for some time, these amounts will not be depreciated or amortized and will remain on the Company's books for a number of years, resulting in the Company over-earning on these amounts if included in rate base as proposed. OCA MB at 40-41.

OCA submits that the Commission should not be persuaded by Mr. Trzaska's claims that the Pension Asset must be included in rate base or else it will not earn a return on these amounts.[173] This is not correct. In future years, when the Company's Cash Contribution is less than the Company's ASC 715 amount, the mismatch in financial accounting will reverse and a portion of the Pension Asset will then be placed into the Company's capital accounts. At that time, that capitalized portion can be placed in rate base and depreciated like any other capital asset. OCA MB at 41.

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168 OCA St. 1-SR at 13.

169 OCA St. 1-SR at 13. .

170 *Id.*

171 OCA St. 1 at 19.

172 *See Pa. Pub. Util. Comm'n v. Pa. Power Co.,* Docket No. R-811510, 1982 Pa. PUC LEXIS 154 at *117-18 (Pa. PUC Jan. 22, 1982) (*Penn Power 1982*).

173 *See* PECO St. 3-R at 16.

In response to Mr. Morgan's recommendation, Company witness Trzaska argues that the Commission already approved this practice in a settlement reached in several Duquesne Light Company rate case proceedings.[174] The OCA submits that this argument should be dismissed without merit as the decision referenced by Mr. Trzaska is the product of a settlement and should not be given precedential value.[175] Moreover, the referenced settlement contained in Mr. Trzaska's Rebuttal Testimony contains the following provision, which was adopted by the Commission:

> The Joint Petitioners acknowledge that this Settlement reflects a compromise and does not necessarily reflect any Party's position with respect to any issues raised in this proceeding. The Joint Petitioners agree that this Settlement shall not constitute or be cited as precedent in any other proceeding, except to the extent required to implement this Settlement.[176]

The OCA further notes that to base approval of the Company's request on the basis that it was adopted and affirmed in these black-box settlements would have a chilling effect on the settlement process itself if it were to be held against the parties in future proceedings. Thus, this argument should be rejected. OCA MB at 41-42; OCA RB at 17.

In addition, Mr. Trzaska tries to compare the Pension Asset to the capitalized portion of salaries and wage expense, stating that these items are similar.[177] Mr. Trzaska, however, inappropriately compares two different concepts. A portion of pension expense, like salaries and wage expenses, must be capitalized and included in the Company's capital accounts.[178] The OCA does not dispute this fact. What concerns the OCA is the Company's proposal to include in rate base pension expense amounts that have not yet been capitalized for financial accounting purposes. This would inappropriately include an unamortized expense item in rate base before it is ripe for inclusion.[179] OCA MB at 42.

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174 *See* PECO St. 3-R at 12-15.
175 *Id*.
176 *Pa. Pub. Util. Comm'n v. Duquesne Light Co.*, Docket No. R-2018-3000124 (Opinion and Order entered Dec. 20, 2018) at 15, 41-42.
177 PECO St. 3-R at 16-17.
178 OCA St. 2-SR at 14-15.
179 *See* OCA St. 2-SR at 16.

Accordingly, the OCA argues that the Commission should deny the Company's claim to include a Pension Asset in rate base. Denial of the Company's claim would reduce the Company's rate base by $35,059,000.[180] OCA MB at 42; OCA RB at 17.

iii. Uncontested Items

The OCA did not brief this specific issue.

4. OSBA's Position

The OSBA did not brief any rate base issues.

5. CAUSE-PA's Position

CAUSE-PA did not brief any rate base issues.

6. PAIEUG's Position

PAIEUG did not brief any rate base issues.

7. ALJ's Recommendation

a. Utility Plant in Service

As previously noted, the OCA proposed an allowance only at the Company's forecasted level of plant additions for the FTY ending June 30, 2021 without an allowance for any incremental plant additions during the FPFTY. The OCA's proposal would result in an approximate reduction of $271 million to PECO's net plant in service. I&E proposed reducing PECO's claimed plant in service balance for the Natural Gas Reliability project. I&E's proposal would result in a reduction of $47,624,803 to PECO's plant in service.

180 OCA St. 2 at 19; *see also* OCA St. 2-SR, Sch. LKM-5, Line 3.

Considering the impact that the COVID-19 pandemic has had on businesses as well as individuals, the concerns raised by I&E and OCA regarding plant in service are understandable. Although the Company offered testimony regarding delays caused by the pandemic on its plant in service goals in the FPFTY, and that PECO does not expect the in-service dates of any of the projects it expects to complete in the FTY or FPFTY to be delayed, PECO did not prove conclusively that it would meet its targeted in-service dates. However, I do not agree with the OCA's position that there is not any support for PECO's planned plant additions for the FPFTY. I do believe that there is sufficient evidence in the record to support an addition to rate base for planned plant additions in the FPFTY. Upon review of the testimony and evidence submitted in this proceeding, I agree with I&E's approach to calculating PECO's plant in service.

As previously noted, I&E calculated that the Natural Gas Reliability project is 28% completed with $33,888,385 spent to date. Dividing the $33,888,385 by 28% indicates that the total project cost is $121,029,946. Therefore, the remaining cost of the project is $87,141,561 ($121,029,946 – $33,888,385). The Company further listed the completion date of this project as June 2023, or approximately 2.5 years remaining to complete the project. Accordingly, I&E determined that the Company is projecting it will spend $87,141,561 over 2.5 years, or, on a linear basis, $34,856,625 per year ($87,141,561 / 2.5 years). As the Company is unlikely to spend 94.6% of the remaining project costs in the FPFTY ($82,481,428 / $87,141.561 x 100%), I&E recommend an allowance of the linearly determined remaining cost share in the FPFTY, or $34,856,625.

I find these calculations to be reasonable and supported by the record. Accordingly, I recommend that the Company's claim for plant additions in the FPFTY be reduced by $47,624,803 (from $82,481,428 to $34,856,625). This will have a corresponding impact on the Company's depreciation reserve, requiring that overall accumulated depreciation be decreased by approximately $804,000 as proposed by I&E.

b. Pension Asset

As previously noted, the Company has included a Pension Asset of approximately $35,059,000 in measures of value for determining PECO's rate base in this proceeding. The Pension asset represents the difference between the portion of pension expense that it assumes to be capitalized for ratemaking purposes and what is actually capitalized and included in the Company's plant accounts for financial accounting purposes. Both OCA and I&E oppose the inclusion of the Pension Asset in PECO's rate base.

The OCA argues that since the Pension Asset is composed of past pension expense that has not yet been capitalized and cannot be included in the Company's capital accounts for some time, it cannot be included in the Company's rate base. I&E argues that PECO's Pension Asset represents a mismatch from a GAAP accounting perspective and a cash contribution method for the expense account in ratemaking, and that these differences between GAAP expense and cash contributions in any given year should not be viewed as a valid reason to inflate the plant amounts in rate base.

I agree with both OCA and I&E that PECO's Pension Asset should not be included in PECO's rate base. In particular, I am persuaded by I&E's reasoning. I&E noted that the Company argued that the Pension Asset is 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 to recover the previously unrecovered associated carrying costs, and that PECO is not seeking their recovery in this case. However, I&E asserted persuasively that the pension asset is created due to the mismatch in GAAP accounting and ratemaking treatment of pension costs, and that there is no real infusion of capital or funds by the investors/stockholders that is eligible for return on investment. I also agree with I&E's assessment that the accumulated balance of the pension asset should not be categorized or described as a utility asset that is used and useful in providing utility services to ratepayers, and as such, should not be included as an eligible asset in the rate base claim to recover the associated carrying costs.

Moreover, PECO's reliance on three "black box" settlements in three Duquesne Light Company cases to support inclusion of pension contributions in rate base is not persuasive. As noted by I&E, "black box" settlements allow the parties to reach an amicable agreement which is a negotiated compromise on the part of all parties. Moreover, these negotiated settlements usually contain "Settlement Condition" language indicating that the settlement reflects a compromise of competing positions, that it does not necessarily reflect any of the parties' positions with respect to any issues raised in the proceeding, and that the terms and conditions of the settlement are limited to the facts of that specific case and are the product of compromise for the sole purpose of settling the case. Moreover, the "Settlement Conditions" typically advise that the settlement is presented without prejudice to the position any party may advance on the merits of the issues in future proceedings, and that the settlement does not preclude the settling parties from taking other positions in base rate proceedings of other public utilities.

The parties to the Duquesne cases referenced by PECO agreed to settlement terms in those cases based upon the evidence submitted and the specific circumstances that existed in those specific cases. To suggest that a settlement in one case should have bearing over the matters in a litigated proceeding would most assuredly go against the intent of the settling parties to the initial proceeding. Moreover, to allow what happened in a prior settlement approved by the Commission to impact the outcome of a litigated proceeding might hinder settlements in future rate cases. This would be contrary to the Commission's preference for negotiated settlements.

Accordingly, I recommend that the Company's claim for a $35,059,000 Pension Asset in rate base be denied.

c. Cash Working Capital

Cash working capital represents the funds needed to pay O&M expenses and taxes that, on average, are incurred in advance of the utility's receipt of revenues. PECO calculated its cash working capital requirement using the accepted, PUC-approved lead-lag method.[181] No party disputed the methodology that the Company employed or challenged its proposed revenue lag, expense lag or net lag (revenue lag minus expense lag). However, O&M expenses are an input to the calculation of cash working capital. For that reason, I&E and the OCA, which have both proposed adjustments to PECO's expense claims, have also calculated different cash working capital allowances.

As I have accepted various adjustments recommended by I&E and the OCA, a rate base adjustment of $54,001 to the cash working capital claim is appropriate.

d. Neighborhood Gas Pilot Rider

Additionally, in accordance with my recommendation at Section V.G.7.c. of this Recommended Decision where I recommend an annual allowance of $5 million for the Company's Neighborhood Gas Pilot Rider instead of the $7.5 million requested by the Company, I recommend that the Company's rate base claim be further reduced by $2.5 million.

e. Uncontested Items

The Company's rate base claim includes $31.6 million representing its investment in materials and supplies and gas storage inventory. PECO explained that amount is the average of PECO's monthly account balances for both items for the thirteen months ended September 30, 2020. No party disagreed with this proposal. As there is no disagreement with this proposal, I recommend that the Commission approve this proposal since this will reflect the most recent thirteen-month historic averages and derivative changes in cash working capital attributable to those updates.

Additionally, I&E recommended that the Company provide the Commission's Bureau of Technical Utility Services and I&E with an update to PECO Exhibits MJT-1 and MJT-2, Schedule C-2, no later than October 31, 2021, which should include actual capital expenditures, plant additions, and retirements by month from July 1, 2020 through June 30,

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[181] PECO St. 3, pp. 16-22; PECO Ex. MJT-1 Revised, Sch. C-4.

2021. I&E also recommended an additional update be provided comparing projected additions and retirements with actual additions and retirements through June 30, 2022, no later than October 1, 2022. As there was no disagreement to this proposal, I recommend that the Commission approve I&E's proposal.

C. <u>Revenues</u>

1. PECO's Position

PECO notes that I&E's witness Cline proposed an adjustment that would increase pro forma present rate revenue for the FPFTY by $358,000 (I&E Ex. No. 3, Sch. 11) based on his criticisms of PECO's forecast of revenue from forfeited discounts (late payment charges).[182] PECO calculated forfeited discount revenue for the FPFTY by first calculating the average forfeited discount revenue for the three years ended December 31, 2019, as a percentage of average past due accounts receivable balances for the same period. The percentage derived from that calculation was applied to PECO's forecast of past due accounts receivable for the FPFTY to develop FPFTY forfeited discount revenue. In addition, PECO reduced its FPFTY level of forfeited discount revenue to account for a permanent waiver of late fees on past due balances for customers enrolled in the Company's Customer Assistance Program.[183] PECO MB at 26-27.

In support of his adjustment, Mr. Cline first contends that PECO's pro forma present rate revenue for the FPFTY does not recognize that increased revenue gives rise to increased forfeited discounts.[184] To the contrary, as Company witness Mr. Trzaska explained, PECO's pro forma revenues reflected this relationship by including a forfeited discount rate in the gross revenue conversion factor that is used to determine the amount of revenue increase required.[185] PECO MB at 27; PECO RB at 17.

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182 *See* I&E St. 3, pp. 24-25.
183 PECO St. 2-R, pp. 7-9; *2019 Amendments to Policy Statement on Customer Assistance Program, 52 Pa. Code §§ 69.261–69.267*, Docket No. M-2019-3012599 (Order entered Nov. 5, 2019). 50 Pa. B. at 1691-1695 (Mar. 21, 2020).
184 *See* I&E St. 3, p. 25; I&E St. 3-SR, p. 12.
185 PECO St. 3-R, p. 21; PECO Ex. MJT-1 Revised, Sch. D-19.

Second, Mr. Cline's adjustment was based on the average ratio of forfeited discounts to total revenues for the three years ended June 30, 2020 and FPFTY distribution revenue. According to Mr. Cline, his recommended approach should be adopted because the use of a three-year historical average is "long enough to smooth out short term variations and short enough to exclude out of date data."[186] However, as Company witness Mr. Stefani pointed out, PECO's approach is reasonable and appropriately reflects the payment characteristics of the Company's current customer base because forfeited discounts are imposed based on past due balances of accounts receivables. Significantly, the linear trend analysis over an eight-year period (2012-2019) presented in Ex. RJS-1-R confirms that forfeited discounts have a much stronger relationship with past due accounts receivable than with overall revenues. This analysis properly excludes calendar year 2020 data in light of the effects of the pandemic on forfeited discounts.[187] Accordingly, I&E's proposal to calculate pro forma forfeited discount for the FPFTY based on a three-year average of the historic relationship with total revenues should be rejected. PECO MB at 27.

2. I&E's Position

I&E recommended that the revenue from forfeited discounts be increased by approximately $358,000 from $926,000 to $1,284,000 under proposed rates for the FPFTY ending June 30, 2022.[188] The $1,284,000 represents 0.195% of $658,591,000 of proposed Gas Service Revenues for the year ending June 30, 2022.[189] I&E further recommended that the forfeited discount amount should be decreased if the Commission grants less than a full increase and recommended that the Company include revenue under proposed rates from forfeited discounts equal to 0.195% of Gas Service Revenues upon determination of the total revenue granted by the Commission.[190] I&E MB at 21-22; RB at 15.

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186 I&E St. 3, p. 25.
187 *See* PECO St. 2-R, pp. 8-9; PECO Ex. RJS-1-R.
188 I&E St. No. 3, p. 24.
189 *Id.*, *citing* PECO Exh. MJT-1, Sch. D-1, ln. 11.
190 I&E St. No. 3, p. 25.

PECO argued that forfeited discounts should be projected for the FPFTY based on their relationship to past due accounts receivables rather than total revenues.[191] The Company argued further that it determined that a period from January 2012 through December 2019 was appropriate to address short term variations in data such as the impact of the COVID-19 pandemic in 2020 claiming that the “best fit” trend lines shown on PECO Exhibit RJS-1-R confirms that forfeited discounts have a much stronger relationship with past due accounts receivable than with overall revenues.[192] I&E MB at 22.

Nevertheless, I&E argues that the Company’s explanation of how it calculates its projected forfeited discount revenue illustrated why that projection is understated.[193] Specifically, the time period shown on PECO Exhibit RJS-1-R does not include a year in which the Company increased its rates.[194] Furthermore, PECO’s explanation of its methodology does not indicate that the increase in rates from the present base rate proceeding was factored into the analysis.[195] Based on the information provided by the Company, it is not possible to determine the level of Accounts Receivable the Company will experience as a result of the base rate increase and, as such, an accurate projection of forfeited discounts cannot be projected based on the Company’s methodology.[196] Further, I&E believes it is reasonable to expect that forfeited discounts revenues will increase when a utility’s base rates are increased as a result of a base rate proceeding.[197] Therefore, a three-year average of the historic relationship of forfeited discounts and total revenue applied to the projected revenue at proposed rates remains the most reasonable method of projecting forfeited discounts.[198] I&E MB at 22-23; I&E RB at 15-16.

In consideration of the above and the record evidence presented by I&E, I&E recommends that the Company include revenue under proposed rates from forfeited discounts equal to 0.195% of Gas Service Revenues upon determination of the total revenue granted by the

[191] PECO St. No. 2-R, pp. 7-9.
[192] PECO St. No. 2-R, pp. 8-9, *citing* PECO Exh. RJS-1-R, p. 2.
[193] I&E St. No. 3-SR, p. 12.
[194] *Id.*
[195] *Id.*
[196] *Id.*
[197] I&E St. No. 3, p. 25.
[198] I&E St. No. 3-SR, p. 13.

Commission.[199] Therefore, I&E recommends that the revenue from forfeited discounts be increased by approximately $358,000 from $926,000 to $1,284,000 under proposed rates for the FPFTY ending June 30, 2022. I&E MB at 23; I&E RB at 16.

3. OCA's Position

The OCA did not brief this specific issue.

4. OSBA's Position

The OSBA did not brief this specific issue.

5. CAUSE-PA's Position

CAUSE-PA did not brief this specific issue.

6. PAIEUG's Position

PAIEUG did not brief this specific issue.

7. ALJ's Recommendation

The only party to propose a revenue adjustment in this proceeding was I&E, who contested the revenue from forfeited discounts contained in PECO's proposed Gas Service Revenues for the year ending June 30, 2022. I&E recommended that the revenue from forfeited discounts be increased 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. Upon review of both parties' positions, PECO witness Stefani's testimony[200] explaining PECO's methodology for calculating forfeited discount revenue was persuasive:

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[199] *Id.*

[200] PECO St. No. 2-R, at 7-9.

Q: Please explain the methodology the Company used to forecast discount revenue.

A: PECO calculated forfeited discount revenue for the FPFTY by first calculating the average forfeited discount revenue for the three years ended December 31, 2019, as a percentage of average past due accounts receivable balances for the same period. The percentage derived from that calculation was applied to PECO's forecast of past due accounts receivable for the FPFTY to develop FPFTY forfeited discount revenue. In addition, PECO reduced its FPFTY level of forfeited discount revenue to account for a permanent waiver of late fees on past due balances for customers enrolled in the Company's Customer Assistance Program.[201] PECO's approach is reasonable because forfeited discounts (late payment charges) are imposed based on past due balances of accounts receivables.

Q: Have you prepared an analysis to compare the relationship of forfeited discounts to past due accounts receivables and total revenues?

A: Yes. PECO Exhibit RJS-1-R consist of two pages. The first page plots the indexed monthly values for: (1) revenue; (2) past due accounts receivable; and (3) forfeited discounts for the period January 2012 through December 2019. As Mr. Cline acknowledges, it is important to utilize a long enough time period to smooth out short term variations. The Company determined the period from January 2012 through December 2019 was appropriate to address such variations, as well as the anomalous impact of the COVID-19 pandemic in 2020. The second page provides "best fit" trend lines which clearly show that forfeited discounts have a much stronger relationship with past due accounts receivables than with overall revenues. In short, PECO Exhibit RJS-1-R confirms that forfeited discounts should be properly projected for the FPFTY based on their relationship to past due accounts receivable, as the Company has done, and not on the basis of total revenues, As Mr. Cline proposes to do.

Since, as PECO points out, forfeited discounts are imposed based on past due balances of accounts receivables, I agree that PECO's approach is reasonable and appropriately reflects the payment characteristics of PECO's current customer base. Moreover, and as explained by

[201] 2019 Amendments Policy Statement on Customer Assistance Program, 52 Pa. Code §§ 69.261-69.267, Docket No. M-2019-3012599 (Order entered Nov. 5, 2019). 50 Pa. B. No. 12 at 1691-1695 (Mar. 21, 2020).

PECO, the linear trend analysis over the period 2012 through 2019 presented in Exhibit RJS-1-R demonstrates that forfeited discounts have a much stronger relationship with past due accounts receivables than with overall revenues.

Accordingly, I recommend that the revenue from forfeited discounts as proposed by the Company be accepted.

D. Expenses

PECO, I&E, and the OCA offered varying recommendations on several of the Company's various expenses. OSBA, CAUSE-PA and PAIEUG did not take positions on any of the expense items at issue. Accordingly, PECO's, I&E's, and the OCA's recommendations regarding these various expenses will be summarized and reviewed below.

1. PECO's Position

a. Payroll and Payroll Related Expenses

PECO's requested payroll allowance for the FPFTY of $42,209,000 was presented by Company witness Mr. Trzaska. This figure was developed based upon PECO's authorized and budgeted employee complement for the FPFTY of 639 full-time equivalent (FTE) positions. PECO also annualized budgeted payroll expenses to reflect wage increases to be granted during the FPFTY. For union and non-union employees, the Company projected 2.5% increases to become effective on January 1, 2022 and March 1, 2022, respectively. Finally, the Company adjusted its FPFTY budgeted data to normalize a one-time cash payment to union employees made in connection with the ratification of PECO's current collective bargaining agreements.[202] PECO MB at 28.

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[202] *See* PECO St. 3, pp. 34-35; PECO Ex. MJT-1 Revised, Sch. D-6.

OCA witness Morgan and I&E witness Patel each proposed adjustments to reduce PECO's claim for payroll expense. As explained below, the Company believes that those proposed adjustments should be rejected. PECO MB at 28.

i. The OCA's Proposed Adjustment

OCA witness Morgan proposed two adjustments that, in aggregate, would reduce PECO's payroll expense claim by $2.477 million. His first adjustment was designed to set the employee complement at the actual level as of September 30, 2020 because, in Mr. Morgan's view, the Company did not provide adequate support for the total net increase of 37 FTE positions PECO has forecasted by the end of the FPFTY. Second, Mr. Morgan recommends an adjustment that would eliminate PECO's normalized ratification bonus paid to union employees.[203] PECO MB at 28-29.

PECO asserts that Mr. Morgan's proposed employee complement allowance of 604 positions, instead of 639 positions as forecasted by the Company for purposes of its payroll claim, is seriously flawed for two principal reasons. First, the rationale for his proposed adjustment – that 37 additional positions would not be filled by the end of the FPFTY – was thoroughly refuted by Mr. Stefani. As Mr. Stefani explained in his rebuttal testimony, those positions include fifteen mechanics, four senior contract coordinators, five engineers, one gas operating mechanic, two clerks, one damage prevention inspector, one workweek manager, one contractor liaison and several energy technicians, whose allocated FTEs to gas operations will total seven employees. As Mr. Stefani also testified, these positions are in the process of hiring and are expected to be filled by the end of the FPFTY.[204] Under similar circumstances, the Commission has rejected adjustments to a utility's payroll expense to account for as yet unfilled positions and it should do so again in this case.[205] PECO MB at 29.

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203 *See* OCA St. 2, pp. 23-25; OCA St. 2-SR, pp. 16-19; Sch. LKM-11.

204 PECO St. 2-R, pp. 11-12.

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

Second, Mr. Morgan suggested that PECO would be unable to achieve its forecasted employee complement of 639 FTEs by the end of the FPFTY because of the COVID-19 pandemic. Yet, as Mr. Stefani noted in his rebuttal testimony,[206] the Company's headcount was 612 FTE employees as of December 31, 2020. There is no basis to exclude the payroll costs for the eight employees added after September 30, 2020, as Mr. Morgan's proposed adjustment would do. More importantly, as Mr. Stefani testified, PECO intends and expects to staff its full, forecasted employee complement by June 30, 2022 despite impacts from the COVID-19 pandemic that temporarily prevented PECO from hiring all anticipated gas operations personnel (635 positions) by the end of 2020. The primary reason for the lower number of positions in 2020 was the cancellation of PECO's Gas Mechanics School in March 2020 due to the pandemic, and the training program has already been rescheduled for September 2021.[207] PECO MB at 29-30, PECO RB at 18-19.

PECO believes that Mr. Morgan's proposal to disallow costs related to the union contract ratification bonus that PECO incurs on a recurring basis should also be rejected. As Mr. Trzaska explained, PECO has consistently paid a ratification bonus to union employees each time it negotiates new union contracts, and there is no reason to believe that PECO will depart from that practice in the FTY and FPFTY.[208] Consistent with Commission practice,[209] PECO's proposal to spread the ratification bonus expense over the average length of the Company's collective bargaining agreements (i.e., six years) is reasonable and appropriate. PECO MB at 30; PECO RB at 20.

Additionally, 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 complement of employees. A review of that order reveals evidentiary deficiencies that are not present here. The Commission reduced Columbia's payroll expense to

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[206] PECO St. 2-R, p. 11.
[207] PECO St. 2-R, pp. 11-12.
[208] PECO St. 3-R, pp. 21-22.
[209] *See* James H. Cawley and Norman J. Kennard, *A Guide to Utility Ratemaking* (2018), p. 86 (quoting *Pa. Pub. Util. Comm'n v. York Water Co.*, 78 P.U.R. 3d. 113, 132 (1968) ("Expenses that occur irregularly during an extended period of years, but are certain of eventual recurrence, are a legitimate charge to ratepayers. Therefore, spreading of this expense over years of recurrence is logical.")).

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).[210] 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. PECO RB at 19-20.

ii. I&E's Proposed Vacancy Rate Adjustment

PECO notes that I&E witness Patel proposed an adjustment to reflect an average of the vacancy rates as of the three years ended June 30, 2020 for PECO's full-time employees (2.1%) that would reduce the Company's payroll-related expense claim by $858,715.[211] PECO maintains that this adjustment is similar to the "vacancy" adjustment proposed by Mr. Morgan, and it should be rejected for the same reasons. PECO MB at 30.

PECO further argues that Mr. Patel improperly applied his calculated vacancy rate to a total of 639 employees, which consists of the 602 actual employees as of the end of the HTY and the 37 employees that PECO will hire over the FTY and the FPFTY. The fundamental error in Mr. Patel's calculation is that the figure of 602 represents the *actual* filled positions for the HTY and does not include any budgeted "vacant" positions. Therefore, there is no basis for adjusting that figure by a "vacancy" rate. As Mr. Stefani explained, if Mr. Patel's proposed vacancy rate were only applied to the 37 employees that PECO will add by the end of the FPFTY, the Company's payroll-related expense claim would be reduced by $46,200 instead of the $858,715 claimed by Mr. Patel.[212] PECO MB at 31.

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210 *See Columbia Gas*, pp. 67-72.

211 I&E St. 1, pp. 12-15; I&E St. 1-SR, pp. 8-10.

212 PECO St. No. 2-R, pp. 10-11.

iii. Employee Benefits Expense and Payroll Taxes

PECO notes that OCA witness Morgan and I&E witness Patel have recommended adjustments to PECO's employee benefits expense and payroll taxes.[213] PECO maintains that these adjustments are concomitant to their proposed adjustments to payroll expense and, therefore, should be rejected for the reasons previously discussed. PECO MB at 31.

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 over the Company's projected FTY contracting and materials expense of $44,651,000. Three initiatives are the principal drivers in the Company's increase over HTY booked amounts budgeted for the FTY and FPFTY: (1) PECO is enhancing its mapping system to improve the Company's ability to locate and track gas distribution facilities and the Company is increasing its investment in its gas mapping project in the FTY; (2) the Company anticipates incremental contracting and materials expense related to PECO's planned activities to reduce its non-emergent leak backlog; and (3) PECO will be required to incur additional security expenses in the FTY for crews working in high-crime areas. Expenses related to these items are anticipated to result in the Company incurring approximately $8 million in incremental spend over prior years, in each of the FTY and the FPFTY.[214] PECO MB at 31-32; PECO RB at 20-21.

I&E witness Patel recommended reducing the Company's claim by approximately $10 million. Mr. Patel contended that the Company failed to adequately explain the increase in contracting and materials expense from the HTY to the FTY, and he asserted that the Company's FPFTY claim is not reliable and reasonable since the FTY increase is reflected in the FPFTY claim. Mr. Patel recommended that the Commission allow the Company to recover only the three-year historical average of its contracting and materials expense.[215] PECO MB at 32.

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[213] *See* OCA St. 2, pp. 25-26, 42 and Schs. LKM-12 and LKM-29; I&E St. 1, pp. 16-18.

[214] PECO Ex. MJT-1 Revised, Sch. D-4; PECO St. No. 2-R, p. 17-19; Hearing Tr. 252-53.

[215] I&E St. 1, pp. 38-40; I&E St. 1-SR, pp. 32-35.

PECO argued that Mr. Patel's recommendation is unreasonable and should be rejected. The actual amount incurred by the Company during the HTY was significantly lower than expected due to temporary impacts from the COVID-19 pandemic. For example, as explained by Mr. Stefani, construction work stoppages in March through June 2020 reduced the need to locate Company facilities, and COVID-related restrictions reduced work levels in the Company's mapping plan and slowed the Company's efforts to repair non-emergent leaks. The Company estimates that these COVID-related impacts reduced its HTY contracting and materials expense by approximately $6 million. This result was an anomaly and not indicative of future levels of the Company's contracting and materials expense. As Mr. Stefani explained at the evidentiary hearing, PECO is already on track with its planned locating and mapping efforts and associated contracting and materials spending in the FTY. In addition, he testified that the Company anticipates that it will be fully caught up on its 2020 construction budget by June 2021 despite temporary delays caused by the pandemic and will meet its FTY and FPFTY budgets for contracting and materials expenses.[216] PECO MB at 32-33.

PECO further argued that it would be unreasonable to utilize a three-year average of the Company's historical contracting and materials expense when the Company's HTY actual expense was a materially lower aberration due to impacts from the COVID-19 pandemic, especially when such impacts have already been mitigated and are not intended to impact the Company's FTY and FPFTY contracting and materials expense. Mr. Stefani fully explained and supported the Company's claimed increase in the FTY and FPFTY in his rebuttal testimony.[217] Moreover, Mr. Stefani noted at the evidentiary hearing that PECO is already on track with its planned locating and mapping efforts and associated contracting and materials spending in the FTY, that the Company anticipates that it will be fully caught up on its 2020 construction budget by June 2021 despite temporary delays caused by the pandemic, and that the Company will meet its FTY and FPFTY budgets for contracting and materials expenses.[218] Therefore, PECO believes that the Commission should reject Mr. Patel's recommendation and approve the Company's claim for contracting and materials expense. PECO MB at 33; PECO RB at 21-22.

216 *See* Hearing Tr. 251-53.
217 PECO St. 2-R, pp. 17-19.
218 *See* Hearing Tr. 251-53.

c. Outside Services (Including Exelon Business Service Company Charges)

PECO is seeking recovery of $22 million in outside services expenses in the FPFTY. This claim is inclusive of PECO's claim related to Exelon Business Services Company (EBSC) expenses. The EBSC was created by Exelon, following the merger of PECO and the former Unicom Corporation, to provide its affiliates with certain functions that it believed could be staffed more efficiently and economically on a centralized basis. Utilization of the EBSC for certain services, such as information technology, finance, human resources, government and external affairs and public policy, and legal services enables PECO to realize economies of scale and scope that it would not be able to realize on a standalone basis.[219] PECO MB at 33; PECO RB at 22.

I&E witness Patel asserted that the Company did not properly support its proposed increase in outside services expenses from the HTY to the FTY. Mr. Patel argued that because the Company had stated its projected increase in total outside services expense are generally due to inflation adjustments, the Company had not justified its anticipated increase in outside services expenses from the HTY to the FTY and FPFTY. Mr. Patel acknowledged that the use of inflation factors could be appropriate to determine the Company's projected outside services expenses. However, in place of the Company's proposal, Mr. Patel recommended adjusting the Company's HTY actual outside services expenses for inflation based on Consumer Price Index ("CPI") factors to determine the allowance for these expenses, resulting in a 2.75% increase from the HTY to the FTY, and a further 2.03% increase from the FTY to the FPFTY.[220] PECO MB at 33-34.

PECO Maintains that the data that Mr. Patel utilized as the basis for his analysis is incorrect. Mr. Patel analyzed only the amount in Federal Energy Regulatory Commission ("FERC") Account 923 set forth on PECO Exhibit MJT-1, Schedule D-4. The approximately $16.5 million figure referenced by Mr. Patel is a result of FERC-based allocations based on the Company's 2019 actual results (since the Company does not budget by FERC account) and

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219 PECO St. 2, pp. 16-21; PECO St. 2-R, p. 15.
220 I&E St. 1, pp. 19-22; I&E St. 1-SR, pp. 14-17.

represents a combination of EBSC contracting charges allocated to Account 923 and PECO contracting charges allocated to Account 923. Mr. Patel should have utilized the GAAP-based projections set forth in PECO Exhibit RJS-1 and Attachment III-A-22(a), included in the Company's initial filing.[221] PECO MB at 34.

Attachment III-A-22(a) shows that the Company's HTY actual outside services expense was $21,640,000. The Company projected a slight decrease in FTY outside services expenses to $21,093,000, with a slight increase to $22,135,000 in the FPFTY. This represents an approximately 4.9% increase over the FTY, but only an approximately 2.25% increase over the HTY, and which is also lower than the Company's historical three-year average for outside services expense.[222] Applying Mr. Patel's CPI factors to the HTY date set forth in Attachment III-A-22(a) produces a greater FPFTY amount than is being sought by the Company. The Commission should therefore reject Mr. Patel's proposed adjustment and approve the Company's outside services expense claim. PECO MB at 34-35; PECO RB at 23-24.

OCA witness Morgan also opposed a portion of the Company's outside services claim. Mr. Morgan stated that the Company should not have utilized inflationary adjustments to determine its FPFTY EBSC claim and proposed adjusting only the "Non-Information Technology (IT) Costs" set forth on Attachment III-A-22(a) by utilizing the Company's historical three-year average for such expenses. Mr. Morgan stated that because the EBSC functional areas are managed by Exelon employees, the Company should be able to utilize "proper budget projections" instead of applying an inflation adjustment. This results in a decrease of $997,000 to the Company's FPFTY claim for O&M expenses.[223] PECO MB at 35.

PECO maintains that Mr. Morgan is also utilizing the wrong data to support his conclusion that the Company's claim for outside services expense should be adjusted. Mr. Morgan only applied an adjustment to the Non-Information Technology (IT) Costs set forth on Attachment III-A-22(a) and ignored the other elements of the Company's outside services claim,

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221 RJS-2-R, pp. 16-17.
222 RJS-2-R, pp. 16-17.
223 OCA St. 2, pp. 36-37; OCA St. 2-SR, pp. 20-22 and Sch. LKM-20.

which includes EBSC IT Costs, Non-Utility Charges, and Other Affiliate Charges. PECO believed that if Mr. Morgan had averaged the Company's total outside services expenses over that same period, he would have determined that the Company's three-year average for outside services expense is $22,258,666, which is slightly higher than the Company's FPFTY claim. PECO MB at 35.

PECO maintains that its claim for an approximately 2.25% increase from the HTY to the FPFTY is reasonable, and that the use of inflationary factors to determine a pro forma expense allowance is consistent with Commission policy.[224] Moreover, adoption of Mr. Morgan's methodology, when applied to the Company's total claim for outside services expense, would result in an even greater FPFTY amount than is being sought by the Company. Therefore, the Commission should also reject Mr. Morgan's proposed adjustment. PECO MB at 35-36; PECO RB at 24.

d. Other Post-Employment Benefits Expense

The Company provides medical-related benefits to eligible retirees through its parent's other post-employment benefits (OPEB), and the Company is claiming OPEB expense of $1,050,000 in the FPFTY. This is a significant increase over prior years' OPEB expenses due to the fact that, prior to 2015, the Company provided eligible retirees a Company-sponsored medical plan with a traditional premium cost-sharing arrangement. In 2014, the Company changed its plan design so that, starting in 2015, PECO began to provide eligible retirees a defined contribution that retirees can use to purchase coverage in the individual Medicare marketplace. As PECO witness Stefani explained, the 2014 plan amendments resulted in a re-measurement of the Company's OPEB obligation, which resulted in a prior service credit recorded to other comprehensive income. This credit was then amortized over the average remaining service period of the active plan participants. The Company's independent third-party actuary, Willis Towers Watson, confirmed that the amortization period will expire in June 2021 (i.e., at the end of the FTY). The expiration of the prior service credits will result in a marked increase in the Company's FPFTY OPEB expense. However, to keep things in perspective, the

224 *See, e.g., Pa. Pub. Util. Comm'n v. Phila. Elec. Co.,* 60 P.U.R. 4th 101 (1984).

Company's FPFTY OPEB expense is still only approximately one-third of what it was in 2010.[225] PECO MB at 36; PECO RB at 24-25.

I&E witness Patel stated that the Company failed to substantiate its claim. Mr. Patel asserted that the Company did not properly support its claim that it would experience an increase in its FPFTY OPEB expense due to the expiration of the prior service credit. He recommended allowing the Company to recover its projected FTY OPEB claim of $270,000 for the FPFTY, thereby reducing the Company's OPEB expense claim by $780,000.[226] PECO MB at 36-37.

PECO asserts that Mr. Patel's recommendation should be rejected. Mr. Stefani presented extensive testimony explaining how the prior service credit was created following the Company's modification to its retiree benefits plan in 2014, how its amortization over the remaining life of the active plan participants resulted in unusually low OPEB expense in recent years, and that the prior service credit will expire in June 2021, resulting in the increased OPEB expense that the Company is claiming.[227] Mr. Patel has not provided any support as to why the Company's FTY OPEB expense claim is reasonable but its FPFTY OPEB expense claim is not. Therefore, the Commission should approve the Company's claim for OPEB expense. (PECO MB at 37; PECO RB at 25.

PECO notes that OCA witness Morgan also asserted that the Company failed to support its claim for FPFTY OPEB expense. In his direct testimony, Mr. Morgan recommended an allowance equivalent to the Company's most recent actual three-year average, resulting in a downward adjustment of $1,085,000.[228] In his surrebuttal testimony, Mr. Morgan revised his calculation resulting in a recommendation to adjust the Company's claim by $486,000.[229] PECO maintains that Mr. Morgan's recommendation should be rejected, and the Company's claim

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225 *See* PECO St. 2, pp. 7-8; PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33; PECO Ex. RJS-1RJ (Confidential), p. 15, PECO Ex. RJS-2RJ (Confidential), p. 15, and PECO Ex. RJS-3RJ (Confidential), p. 3.
226 I&E St. 1, pp. 42-44; I&E St. 1-SR, pp. 37-39.
227 PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33.
228 OCA St. 2, pp. 26-27; LKM-13.
229 OCA St. 2-SR, p. 19; OCA Sch. LKM-13.

should be approved, for the same reasons stated in response to Mr. Patel's OPEB expense recommendation. PECO MB at 37.

PECO concludes that 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. PECO RB at 25-26.

e. Costs to Achieve Exelon /PHI Merger

The 2016 merger of PECO's parent, Exelon Corporation, with Pepco Holdings, Inc. resulted in significant cost savings to PECO. As acknowledged by I&E, the merger has already resulted in savings to PECO and its customers of approximately $4.3 million in the last five years. However, as explained by PECO witness Trzaska, Exelon also incurred certain costs to integrate the merged companies in order to produce the merger savings that the Company and its customers continue to realize (the "costs to achieve" the merger, or "CTA" costs). The Company sought recovery of its allocable portion of the CTA expenses, totaling $1,111,000, over a three-year amortization period.[230] PECO MB at 37-38; PECO RB at 26.

Mr. Patel and Mr. Morgan recommended that the Commission disallow the Company's entire CTA claim. Mr. Patel and Mr. Morgan contended that the Company's CTA claim consists of costs incurred prior to the HTY for which the Company did not obtain deferral approval from the Commission, and that approval of recovery in this rate case would constitute improper retroactive ratemaking. Mr. Patel and Mr. Morgan also stated that it would be inappropriate for the Company to recover its CTA when the merger-related savings were realized in prior years and not shared with customers.[231] PECO MB at 38; PECO RB at 26.

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230 PECO St. 3, pp. 40-41; PECO Ex. MJT-1 Revised, Sch. D-15; PECO St. 2-R, p. 12.

231 I&E St. 1, pp. 22-25; I&E St. 1-SR, pp. 18-20; OCA St. 2, pp. 33-36; OCA St. 2-SR, pp. 19-20; OCA Sch. LKM-19.

The Company argues that the Commission should reject Mr. Patel's and Mr. Morgan's proposed disallowance. The Commission may permit recovery of prior period unanticipated, extraordinary, and non-recurring expenses without violating the prohibition against retroactive ratemaking.[232] The Company's CTA is a discrete and limited amount and they produced substantial benefits that extend into future accounting periods. Moreover, it is appropriate to recognize costs in a given accounting period that produce substantial benefits that extend into future accounting periods. PECO MB at 38; PECO RB at 26.

The Company's allocated CTA expense was not fully known until after the 2018 CTA was determined. Moreover, and more importantly, this expense is tied to merger benefits that PECO's customers are continuing to benefit from and which will continue in the future. Mr. Patel's and Mr. Morgan's assertions that the Company's customers have not shared in the benefits from the merger is without merit. The merger-related savings are passed on to customers through reduced costs to Exelon's distribution utilities, including PECO. The fact that the Company has not sought a rate increase since 2010 is in part due to the savings achieved from the merger. These savings are also reflected in the Company's requested increase in this base rate case, which is lower than it would be had the merger not resulted in significant savings to PECO and its customers.[233] PECO asserts that since its 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, it is only fair that customers should bear a portion of the costs incurred to produce those savings. PECO MB at 38-39; PECO RB at 27.

Mr. Patel also contended that the Company's proposed three-year amortization period is inappropriate.[234] PECO believes that a three-year amortization period is reasonable because it corresponds to the period that rates established in this rate case are anticipated to be in effect.[235] PECO MB at 39; PECO RB at 27.

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232 *See Popowsky v. Pa. Pub. Util. Comm'n*, 695 A.2d 448, 452 (Pa. Commw. Ct. 1997).
233 *See* PECO St. 2-R, pp. 12-14.
234 I&E St. 2, p. 24; I&E St. 2-SR, p. 19.
235 *See* PECO St. 3, pp. 36, 40-41; PECO St. 3-R, pp. 22-23.

f. Regulatory Commission Expenses/General Assessments

PECO notes that OCA witness Morgan proposed an adjustment to reduce PECO's claim for regulatory commission expenses to the HTY level of general assessments for the Commission, the OCA and OSBA, on the ground that the Company purportedly did not explain in detail the nature of the projected increase of $462,000 in the FPFTY.[236] However, as Mr. Stefani explained, the Company's actual 2020-2021 (FTY) general assessments totaling $2,022,423, which is an increase of $288,000 (16.6%) over the HTY level of expense, substantiate the Company's FPFTY claim of $2,197,000. In fact, using the actual percentage increase in general assessments for the FTY to set FPFTY rates would result in a 16.6% increase in FPFTY general assessments and a $161,000 increase to the Company's original claim.[237] In addition, as previously explained, Mr. Morgan's assertion that the use of inflation factors in PECO's budgeting process are inappropriate is contrary to Commission ratemaking practice. In sum, PECO's well-considered budget estimate for FPFTY general assessments is a reasonable allowance for these expenses and should be approved. PECO MB at 39-40; PECO RB at 27.

g. Research and Development Expenses

The Company's FPFTY claim of $280,000 for research and development (R&D) expense was based upon sound budgeting techniques that reviewed NYSearch R&D programs to enhance safety and productivity in the natural gas distribution industry.[238] OCA witness Morgan proposed to reduce the Company's claim by $180,000 to reflect what he contends is a normalized level of R&D expense. Specifically, he proposed the use of a three-year average of R&D expense in lieu of the Company's budgeted amount for the FPFTY. Mr. Morgan argues, as the primary basis for his proposal, that PECO's FPFTY claim for R&D expense appears "abnormally high" compared to previous years.[239] PECO MB at 40.

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236 OCA St. 2, p. 38; OCA Sch. LKM-22.

237 *See* PECO St. 2-R, p. 20; PECO Ex. RJS-2-R.

238 PECO St. 2-R, p. 20.

239 *See* OCA St. 2, p. 37; OCA Sch. LKM-21.

Mr. Morgan's proposed adjustment that would reduce the Company's claim to a level even lower than PECO's actual HTY expense should be rejected. The evidence shows that there is no basis to assume, as Mr. Morgan did, that historic averages reasonably reflect PECO's current or likely future R&D expenses. To the contrary, PECO's historic R&D expense level for the years ended June 30, 2018 and 2019 was abnormally low because a significant amount of the Company's R&D budget was redeployed in each of those years to offset higher priority needs to manage gas operating expenses, such as emergent gas leak events.[240] Accordingly, PECO maintains that 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. PECO MB at 40; PECO RB at 28.

h. Employee Activity Costs

PECO has proposed to recover the costs of certain employee activities totaling $139,402 that provide important benefits in terms of employee morale and productivity. The Company's annual picnic and other special events in which PECO celebrates its workforce, their accomplishments and strategic goals and initiatives for the upcoming year help make PECO an attractive workplace and incentivize high levels of customer service.[241] Witnesses for I&E and the OCA both proposed adjustments to the Company's FPFTY claim for employee activity costs. PECO MB at 41; PECO RB at 28.

I&E witness Patel proposed to disallow PECO's employee picnic and celebrations claim of $80,933, asserting that those costs for Company sponsored employee events are discretionary expenditures that are not necessary for the provision of safe and reliable utility service.[242] Mr. Patel's position is contrary to the Commission's prior decision rejecting similar adjustments. The costs challenged by Mr. Patel relate to employee recognition events, which the

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240 PECO St. 2-R, p. 20.
241 PECO St. 2-R, p. 21.
242 I&E St. 1, p. 26; I&E St. 1-SR, pp. 20-22.

Commission has found may properly be included in a utility's operating expenses for ratemaking purposes.[243] PECO MB at 41.

OCA witness Morgan questioned whether the employee activity costs that PECO would incur during the FPFTY would be as high as the Company projected because of "uncertainty" caused by the COVID-19 pandemic and contended that PECO's HTY experience should be used to determine the allowance for these expenses.[244] In his rebuttal testimony, Mr. Stefani affirmed that PECO experienced abnormally low spending on employee activities during the HTY because of the Commonwealth's response to the COVID-19 emergency, including stay-at-home orders in effect during the second quarter of 2020, which are unlikely to recur in 2021 and 2022.[245] PECO MB at 41-42; PECO RB at 29.

Accordingly, PECO asserts that the adjustments proposed by I&E and the OCA to PECO's claim for employee activity expenses should be rejected. PECO MB at 42.

i. Travel, Meals and Entertainment

PECO notes that both I&E and the OCA take issue with the Company's claim for employee travel, meals, and entertainment expenses in light of the decline in business travel caused by the COVID-19 pandemic. I&E witness Patel proposed to apply inflation factors to PECO's HTY experience to arrive at his allowance of $862,153 for these expenses based solely on his observation that PECO's forecasted level of expenses for the FPFTY reflects a 22.13% increase over its FTY claim.[246] OCA witness Morgan, in turn, proposes to disallow all but PECO's HTY level of expenses.[247] PECO MB at 42.

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243 *See, e.g., Pa. Pub. Util. Comm'n v. Citizens' Elec. Co.*, Docket No. R-2019-3008212 (Opinion and Order entered Apr. 27, 2020), p. 75; *Pa. Pub. Util. Comm'n v. UGI Utils., Inc. – Elec. Division*, Docket No. R-2017-2640058 (Opinion and Order entered Oct. 25, 2018) (*UGI Electric 2018*), pp. 70-71.

244 OCA St. 2, p. 40; OCA Sch. LKM-24.

245 PECO St. 2-R, p. 22.

246 I&E St. 1, pp. 41-42; I&E St. 1-SR, pp. 35-37.

247 OCA St. 2, p. 41; OCA Sch. LKM-25.

PECO maintains that the allowances for travel, meals and entertainment expenses proposed by Messrs. Patel and Morgan are not appropriate. First, PECO's budgeted data for the FPFTY is more representative of the current and future conditions than the HTY data Mr. Morgan uses, which reflects COVID-19 travel restrictions and stay-at-home orders in place during the second quarter of 2020. In addition, both witnesses ignore the fact that the decline in business travel that forms the basis of their proposed adjustments will be alleviated by increasing vaccinations and other measures to mitigate transmission of COVID-19 during the FPFTY.[248] PECO MB at 42.

j. Membership Dues

The Company claimed membership dues expense of $646,899 in the FTY and $655,897 in the FPFTY. I&E Witness Patel recommended a reduction of $67,762 in the FPFTY, contending that the Company failed to properly support its claim and recommended that the Commission reduce the Company's claim by applying inflation factors of 2.75% and 2.03% to the Company's HTY membership dues to determine the FTY and FPFTY expenses.[249] PECO MB at 42-43.

PECO maintains that its budgeted amounts for membership dues in the FTY and FPFTY are reasonable. As shown on Revised Attachment IE-RE-28-D(a),[250] the Company's actual membership dues expense has fluctuated in the prior three years. PECO's actual expense in July 2017 through June 2018 was $586,041, increasing to $689,986 in July 2018 through June 2019 (an approximately 17.5% increase), and decreasing to $561,005 in the HTY (an approximately 18.5% decrease):[251]

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%

[248] *See* PECO St. 2-R, pp. 22-23.
[249] I&E St. 1, pp. 27-29; I&E St. 1-R, pp. 22-25.
[250] The Company's response to Interrogatory IE-RE-28-D was provided in I&E Exhibit No. 1-SR.
[251] I&E St. 1-SR, p. 24.

PECO submits that 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.

In light of those fluctuations, PECO asserts that Mr. Patel's proposed adjustment that would reduce PECO's claim below the historic average of actual membership dues (approximately $612,000 over the three years ended June 30, 2020) is inappropriate.[252] PECO MB at 43.

k. Injuries and Damages

The Company's FPFTY claim for injuries and damages expense of $638,000 is derived from a third-party actuarial report obtained by the Company. OCA witness Morgan proposed to normalize the Company's claim for injuries and damages expense based on the Company's historical three-year average. This would result in a $464,000 downward adjustment.[253] PECO MB at 43.

PECO argued that the Commission should reject Mr. Morgan's proposed adjustment. As explained by PECO witness Stefani, utilization of a three-year average would be unreasonable since the negative $9,000 injuries and damages expense for the twelve months ended June 30, 2019 was due to an actuarial update to the Company's workers' compensation, bodily injury and property damage reserve for that period. The prior year's actual expense for the twelve months ended June 30, 2018 was $301,000 and the following year's actual expense for the twelve months ended June 30, 2020 was $231,000. The negative 2019 amount is an

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252 *See* PECO St. 2-R, p. 23.
253 OCA St. 2, p. 30; OCA St. 2-SR, pp. 23-24; Sch. LKM-16.

aberration that unreasonably skews the Company's three-year average downwards.[254] PECO MB at 43-44; PECO RB at 31.

PECO notes that 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.*[255] 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.[256] PECO maintains that the negative $9,000 expense from 2019 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.[257] PECO RB at 30-31.

PECO maintains that the budgeted amounts for FTY and FPFTY injuries and damages expense, on the other hand, are derived from the independent third-party actuarial reports obtained by the Company, and which were shared with the parties. PECO submits that it would be unreasonable to normalize this expense based on a three-year average when one of those three years was abnormally low, and the Company expects a marked increase in this expense based upon its third-party actuarial reports. Accordingly, PECO requests that the Commission reject Mr. Morgan's proposed adjustment. PECO MB at 44; PECO RB at 31.

l. Property Taxes

The Company's claim for property tax expense was based on the Company's most recent actual property tax bills from 136 municipalities with an adjustment to apply a 2.5% inflation factor.[258] OCA witness Morgan adjusted the Company's claim downwards by eliminating the application of the 2.5% inflation factor, solely since he disagrees with the use of adjustments based on inflation escalations.[259] PECO MB at 44.

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[254] PECO St. 2-R, p. 24.
[255] *See also* James H. Cawley and Norman J. Kennard, *A Guide to Utility Ratemaking* (2018), p. 86.
[256] *Id.*, p. 85.
[257] *See* PECO St. 2-R, p. 24.
[258] PECO St. 2-R, pp. 24-25.
[259] OCA St. 2, pp. 41-42; OCA Sch. LKM-28.

PECO argued that Mr. Morgan's adjustment should be rejected. It is reasonable to assume that the Company's property tax expense will increase consistent with the inflation adjustment utilized by the Company. However, even if the Commission were to determine that an inflation adjustment is not warranted, Mr. Morgan's proposed adjustment should still be rejected. PECO MB at 44.

Mr. Morgan applied his adjustment to PECO's entire budgeted amounts for property taxes in the FTY ($3.594 million) and FPFTY ($3.618 million). However, these amounts are comprised of two components: Public Utility Realty Tax (PURTA) and real estate tax. PECO's budgeted amounts for PURTA do not reflect an inflation rate since they were derived directly from the 2019 Pennsylvania PURTA Notice of Determination.[260] Eliminating the 2.5% inflation factor solely from the real estate tax portion of the Company's claim for property taxes (to which it was applied by the Company) would only reduce the Company's claim by $61,395 instead of the $112,000 reduction proposed by Mr. Morgan. However, the Company maintains that its application of a 2.5% inflation factor was reasonable and consistent with Commission practice. PECO MB at 44-45.

The Company notes that the OCA cited to *Pa. Pub. Util. Comm'n v. Wellsboro Elec. Co.*[261] 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.[262] 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.[263] The exact amount of future property tax assessments cannot be known at this time. However, PECO believes it is reasonable to assume that the Company's property taxes will increase on par with a reasonable rate of inflation. Accordingly, PECO submits that the Commission should find

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260 PECO St. 2-R, pp. 24-25; PECO Ex. RJS-3-R.

261 *Pa. Pub. Util. Comm'n v. Wellsboro Elec. Co.*, Docket No. R-2019-3008208, 2020 WL 2487415 (Pa. P.U.C. Apr. 29, 2020).

262 *Id.*, pp. *22-23.

263 *See Pa. Pub. Util. Comm'n v. Pa. Gas & Water Co.*, Docket No. R-00922482, 1993 WL 856537, p. *31 (Pa. P.U.C., June 23, 1993).

that the Company's proposed inflation adjustment is reasonable and deny the OCA's proposed adjustment. PECO RB at 32.

m. Energy Efficiency and Conservation Program Costs

PECO requested $4.5 million in annual funding for its gas energy efficiency and conservation (EE&C) programs. This funding request would increase the annual budget of the gas EE&C program and allow PECO to expand program offerings to residential customers and income-eligible customers, pursue innovative pilot projects, and support new marketing and outreach to increase customer participation in the program.[264] As for the cost-effectiveness of the proposed program, PECO revised its analysis to correct certain calculational errors identified by OCA witness Geoffrey C. Crandall. The Revised Analysis found that the proposed program had a total resource cost (TRC) of 1.02 and is thus cost effective.[265] PECO MB at 45.

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

I&E witness Patel recommended a disallowance of $1,772,500. This disallowance, if granted, would fund the Company's EE&C program at $2,727,500 per year (a 39% decrease from the Company's request).[266] Mr. Patel stated that while he did not oppose the introduction of new rebate programs, he believed that the Company could accommodate the cost of these programs within his recommended program budget.[267] In response, the Company acknowledged that past program participation levels did not meet projections, but more targeted marketing efforts and trade ally engagement were planned to increase customer participation and justified the full program funding proposed by PECO.[268] PECO MB at 45-46.

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264 *See* PECO St. 9, pp. 6-10; *see also* PECO St. 9-R, pp. 4-6.
265 *See* PECO St. 9-R, pp. 2-3.
266 *See* I&E St. 1, p. 34; *see also* I&E St. 1-SR, pp. 27, 32.
267 *See* I&E St. 1, p. 34.
268 *See* PECO St. 9-R, pp. 3-6.

ii. OCA Criticism of the Cost-Effectiveness of the EE&C Program

OCA witness Crandall criticized the cost-effectiveness of the Company's proposed EE&C program.[269] In particular, Mr. Crandall identified an error in PECO's analysis of its smart thermostat program. Mr. Crandall stated that correcting this error would cause the smart thermostat program not to be cost effective and would reduce the cost-effectiveness of the overall EE&C program.[270] PECO's Revised Analysis corrected this error and made several other adjustments to address Mr. Crandall's recommendations.[271] Under the Revised Analysis, PECO's proposed program was still cost effective, with a TRC of 1.02.[272] PECO MB at 46.

Mr. Crandall agreed with all but one of the changes PECO made in its Revised Analysis. His one disagreement was that PECO included the electricity savings from a high-efficiency gas furnace with electronically commutated motor (ECM) fans but did not include the incremental measure cost for the ECM fan in its analysis.[273] In her oral rejoinder testimony, Ms. Masalta explained that the cost of the ECM fan was included in the cost for high-efficiency furnaces in the Revised Analysis, and, therefore, the program remained cost-effective.[274] PECO MB at 46.

The Company believes that the Commission should approve its requested allocation for its cost-effective programs. These expanded and enhanced program offerings will provide energy savings for residential and low-income customers and increase overall customer participation. PECO MB at 46.

n. Rate Case Expense Normalization

PECO has claimed an allowance for rate case expense in the aggregate amount of $1.6 million and is proposing to amortize this amount over a three-year period, resulting in a

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269 *See* OCA St. 6, pp. 4-6, 11-19.
270 *See* OCA St. 6, pp. 17-19.
271 *See* PECO St. 9-R, pp. 2-3.
272 *See* PECO St. 9-R, p. 3.
273 *See* OCA St. 6-SR, pp. 4-6.
274 *See* Hearing Tr. 206-208.

normalized claim of $520,000 per year. As explained by Mr. Trzaska, PECO projects that it will need to file another rate case in three years, which formed the basis for the three-year normalization period the Company used in this case.[275] PECO MB at 47.

While I&E witness Patel and OCA witness Morgan did not question the amount of PECO's total claimed rate case expense, they suggested that the amortization period should be five years rather than three years. Both witnesses based their proposed five-year normalization period on an approximate average of the historical interval between the filing of the Company's 2008 and 2010 rate cases (two years) and between its 2010 and current base rate cases (ten years).[276] PECO MB at 47.

PECO submits that the Company's proposed three-year normalization of rate case expense is reasonable and should be adopted. PECO's projected need for rate relief in three years will be driven by the capital requirements of the Company's planned infrastructure improvement programs. Indeed, Mr. Stefani testified that PECO needs to invest approximately $1.2 billion in new and replacement gas utility plant between July 1, 2020 and June 30, 2024.[277] With that level of investment and even marginal year-over-year increases in operating and maintenance expenses, it is not reasonable to assume, as Messrs. Patel and Morgan have, that PECO could delay a subsequent base rate filing for five years.[278] PECO MB at 47.

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

> As previously discussed, this proceeding is premised upon a FTY and based on that criterion, certain expenses may be now based on

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275 *See* PECO St. 3, p. 36; PECO St. 3-R, p. 22; PECO Ex. MJT-1 Revised, Sch. D-7.
276 *See* I&E St. 1, pp. 5-11; I&E St. 1-SR, pp. 6-7; OCA St. 2, pp. 30-31; OCA Sch. LKM-17.
277 PECO St. 2, p. 3.
278 PECO St. 3-R, p. 22.

> future expectations. We believe the normalization period for rate case expense is one of those expenses.[279]

The Commission affirmed that practice for determining the normalization period for rate case expense in *UGI Electric 2018* (pp. 59-60) even though it had been over twenty years since UGI Electric had filed a request for a base rate increase. PECO MB at 47-48.

o. Regulatory Initiatives

PECO has claimed $47,000 to amortize over a period of three years the O&M and depreciation expenses that the Company incurred to establish a Gas Procurement Charge (GPC) and Merchant Function Charge (MFC) pursuant to the Commission-approved settlement of PECO's natural gas unbundling rate proceeding at Docket No. P-2012-2328614 (Gas Unbundling Settlement). In its rebuttal case, the Company accepted OCA witness Morgan's proposed adjustment to regulatory initiative expenses that would eliminate the costs that PECO incurred prior to the HTY in this case to implement its Neighborhood Gas Pilot Program.[280] PECO MB at 48.

I&E witness Patel did not disagree that PECO's claimed regulatory initiative expenses are proper and recoverable. Nonetheless, he proposed an adjustment to increase the period over which these expenses are to be amortized for ratemaking purposes from three years, as the Company proposed, to five years. That change would reduce the annual amortization amount included in operating expenses in this case by $18,800. The only reason Mr. Patel offered for lengthening the amortization period is that doing so would be consistent with his recommendation to normalize rate case expense over five years.[281] PECO submits that Mr. Patel's alternative proposed normalization period should be rejected for the reasons discussed previously. PECO MB at 48-49.

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279 *PPL 2012*, pp. 47-48.

280 *See* PECO St. 3, p. 40; PECO St. 3-R, pp. 4, 24; PECO Ex. MJT-1 Revised, Sch. D-14.

281 *See* I&E St. 1, pp. 30-31; I&E St. 1-SR, pp. 25-27.

OCA witness Morgan proposed an adjustment to reduce PECO's regulatory initiative expenses by $20,570 to remove certain O&M expenses related to GPC/MFC implementation, he alleges were not authorized for deferral and recovery. However, Paragraph 39 of the Gas Unbundling Settlement, which is quoted in Mr. Morgan's direct testimony,[282] expressly authorized PECO to defer costs associated with system changes necessary to establish and implement the GPC and MFC, including information technology (IT) programming costs, and to seek recovery in the Company's next rate case. In addition to capitalized software costs, PECO incurred $20,570 in operating expenses related to system changes necessary to implement the GPC and MFC, including design, project management and training costs.[283] PECO submits that Mr. Morgan's proposed adjustment that would not recognize those IT-related operating expenses is inconsistent with the Gas Unbundling Settlement and should be rejected. PECO MB at 49.

p. Manufactured Gas Plant Remediation Expense

PECO has undertaken positive efforts to remediate former manufactured gas plant ("MGP") sites in its service territory consistent with the standards established by the Pennsylvania Department of Environmental Protection (PADEP). As PECO witness Bradley testified, the Company intends to achieve regulatory closure with PADEP for 24 of the 26 presently identified MGP sites by the end of 2023.[284] PECO has claimed $804,000 to amortize the $7.237 million that the Company will not have recovered through current rates for its MGP remediation liability at June 30, 2021 over a period of nine years.[285] The OCA is the only party that has objected to PECO's proposed MGP remediation expense allowance. PECO MB at 49-50.

While OCA witness Morgan did not take issue with PECO's estimated unrecovered MGP remediation liability, he proposed an adjustment to increase the period over which these expenses are to be amortized for ratemaking purposes from nine years, as the

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282 OCA St. 2, p. 32.
283 PECO St. 3-R, pp. 24-25.
284 PECO St. 1, pp. 13-14.
285 PECO St. 3, pp. 39-40; PECO Ex. MJT-1 Revised, Sch. D-13.

Company proposed, to fourteen years. That change would reduce the annual amortization amount included in operating expenses in this case by $287,000.[286] As noted by Mr. Morgan, the settlements achieved in PECO's 2008 and 2010 gas base rate proceedings included a cost recovery mechanism for MGP remediation. The 2010 settlement provided that the Company's reset of its MGP remediation expense allowance would be based on a normalized annual level of MGP remediation costs that PECO will incur over the remainder of its remediation program. In light of the estimated dates of completion for all of the MGP projects, PECO believes that nine years (i.e., three subsequent base rate cases) is a reasonable amortization period.[287] PECO MB at 50.

Mr. Morgan also recommended that PECO be required to impute carrying costs on $14.3 million of MGP remediation expenses that he alleges PECO "over-collected" through base rates.[288] As a threshold matter, PECO has not "over-collected" funds for MGP remediation; the MGP funds PECO has received from customers have been and will be spent on MGP projects. However, PECO has agreed to pay interest on the monthly balance of MGP funds that are not yet spent on remediation activities at the residential mortgage lending rate specified by the Secretary of the Pennsylvania Department of Banking and Securities after July 1, 2021, when new rates will take effect. This interest will accrue and be applied to reduce revenue requirements in PECO's next gas base rate proceeding.[289] Consequently, PECO believes that it has addressed Mr. Morgan's concerns regarding carrying costs on PECO's regulatory asset for MGP remediation. PECO MB at 50-51.

q. Depreciation Expense

PECO has claimed an annual depreciation expense allowance of $86,146,000[290] based on depreciation calculations performance by Ms. Fulginiti. No party in this case disputed the reasonableness of the Company's proposed depreciation rates. PECO notes that OCA

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286 *See* OCA St. 2, pp. 29-30; OCA Sch. LKM-15.
287 PECO St. 3-R, pp. 25-26.
288 OCA St. 2, p. 30.
289 *See* PECO St. 3-R, p. 26.
290 PECO Ex. MJT-1 Revised, Sch. D-1

witness Morgan and I&E witness Cline have recommended adjustments to depreciation expense.[291] PECO maintains that these adjustments, however, are concomitant to their proposed adjustments to accrued depreciation related to plant additions and, therefore, should be rejected for the reasons discussed related to Rate Base. PECO MB at 51.

2. I&E's Position

a. Payroll and Payroll Related Expenses

I&E recommended an allowance of $41,350,285 for payroll expense, or a reduction of $858,715 ($42,209,000 - $41,350,285) to the Company's claim.[292] I&E's recommendation is based on employees' unfilled (vacant) positions (that are budgeted in the FPFTY claim), calculated based on PECO's historic average annual vacancy rate of 2.10% as experienced in the fiscal years ended June 30, 2018; June 30, 2019; and June 30, 2020.[293] The Company's claim, based on the assumption that it will maintain a 100% full staffing level as budgeted in the FPFTY throughout the whole year, is simply unrealistic since there will always be a certain number of normal vacancies due to retirements, resignations, transfers, layoffs, etc. on a day-to-day operational basis.[294] These vacancies are unpredictable and there will always be search and placement time involved in filling vacancies.[295] I&E MB at 24; I&E RB at 16.

PECO argued that the FPFTY claim for payroll expense of 639 budgeted employee positions did not include any positions that were vacant at the end of the historic test year (HTY) as of June 30, 2020.[296] In short, the Company argues its FPFTY payroll expense claim reflects 602 filled positions as of June 30, 2020 and 37 new positions to be filled by end of the FPFTY totaling 639 positions.[297] Additionally, the Company put forward an irrelevant and unsupported argument that if I&E's recommended employee vacancy rate of 2.10% is applied

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291 *See* OCA St. 2, p. 41; OCA Sch. LKM-27; I&E St. 3, pp. 12-14.
292 I&E St. No. 1, p. 12.
293 *Id.*, pp. 12-15.
294 *Id.*, pp. 14-15.
295 *Id.*, pp. 12-15.
296 PECO St. No. 2-R, p. 9-11.
297 *Id.*, p. 10.

only to the proposed 37 additional/new positions (to be filled by end of the FPFTY), payroll expense will merely be reduced by $46,200 instead of $858,715.[298] I&E MB at 24-25.

In response, I&E notes that, PECO did experience normal employee vacancies when the monthly actual filled positions are compared to the budgeted monthly positions during the last three fiscal years,[299] which I&E summarized in the table on page 9 of I&E witness Patel's surrebuttal testimony.[300] Secondly, PECO's assertion that the FPFTY 639 budgeted positions do not include vacant positions is not reliable nor acceptable because PECO's FPFTY payroll expense claim is calculated based on the total budgeted 639 positions to be maintained/filled throughout the FPFTY.[301] Additionally, PECO's FPFTY budgeted positions were calculated based on 602 filled positions as of June 30, 2020, which is subject to change every month due to unpredictable normal vacancies; therefore, the average monthly vacancies should be reflected in payroll expense.[302] Therefore, adjusting payroll expense by applying PECO's average annual normal vacancy rate of 2.10% to the 639 budgeted positions to determine the FPFTY payroll expense allowance represents a fair and reasonable adjustment to PECO's payroll expense claim.[303] I&E MB at 25-26.

Finally, I&E disagrees with PECO's irrelevant and unsupported statement that the vacancy rate of 2.10% should only apply to the 37 new positions, thereby producing a reduction of $46,200 to payroll expense.[304] More correctly, I&E's method of applying the vacancy rate of 2.10% to the total 639 budgeted positions because normal vacancies will occur across the board in the total budgeted positions and not merely with respect to the proposed new positions should be adopted by the Commission. I&E MB at 26; I&E RB at 17-18.

298 *Id.*, pp. 10-11.
299 *See* I&E St. No. 1, pp. 12-13.
300 *See* I&E St. No. 1-SR, p. 9.
301 I&E St. No. 1-SR, p. 10.
302 *Id.*
303 *Id.*
304 *Id.*, p. 11.

In consideration of the above and the record evidence presented by I&E, I&E recommends an allowance of $41,350,285, and accordingly, a reduction of $858,715 to PECO's claim of $42,209,000 payroll expense.[305] I&E MB at 26.

I&E further recommended an allowance of $5,797,603 for employee benefits expense, or a reduction of $120,397 ($5,918,000 - $5,797,603) to the Company's claim.[306] I&E's recommendation was based on the reduction to payroll expense for the vacancy adjustment discussed *supra*. And, because I&E rejected the Company's arguments regarding the payroll expense adjustments, I&E continues to recommend an allowance of $5,797,603 for employee benefits, and accordingly, a reduction of $120,397 to PECO's claim of $5,918,000.[307] I&E MB at 26; I&E RB at 17-18.

b. Contracting and Materials Expense

I&E recommended an allowance of $32,940,000, or a reduction of $10,015,000 ($42,955,000 - $32,940,000) for contracting/materials cost.[308] I&E's recommendation is based on an average of the last three years' expense because PECO's peculiar and significant increase in the FTY and FPFTY claims are unsupported and speculative; and, the Company has experienced budgeted underspent expense levels in the prior three fiscal years.[309] I&E MB at 27; I&E RB at 18.

PECO disagreed and argued the increase in the FTY and FPFTY budgeted claims can be attributed three factors outlined previously. However, I&E maintains that the Company's claims are unsupported. In PECO's discovery responses the Company stated that the increase in its FTY expense claim was due to lower than expected spending in the HTY driven by the impact of COVID-19 pandemic-related restrictions.[310] The Company estimated that these COVID-related impacts reduced its HTY contracting and materials expense by approximately $6

305 I&E St. No. 1, p. 12.
306 I&E St. No. 1, p. 16.
307 I&E St. No. 1-SR, p. 12.
308 I&E St. No. 1, p. 39.
309 *See* I&E St. No. 1, pp. 39-40.
310 *See* I&E St. No. 1-SR; I&E Exh. No. 1, Sch.9., p. 2.

million. The Company mentioned additional planned activities for the FTY that increased the FTY claim;[311] however, the Company, did not provide the projected FTY and FPFTY spending for each of the planned additional activities, such as, a breakdown of contracting and materials expenses by category, and the basis of projection for these expenses to be incurred in the FTY and FPFTY.[312] Further, in the absence of a detailed explanation and support for the significant increase of 51.09% from the HTY to the FTY expense claim, neither the FTY nor the FPFTY expense claim are reasonable, prudent or reliable because the FTY increase is reflected in the FPFTY claim.[313] I&E maintains that the Company has not provided any substantial evidence to support the claim that all the projected expense increases in the FTY for new planned activities will continue to be incurred in the FPFTY.[314] I&E MB at 27-28; I&E RB at 19.

Finally, I&E notes that the Company's actual contracting and materials expenses were underspent by 11.42% in 2017-18, 2.76% in 2018-19, and 24.46% in 2019-20 as compared to the budgeted expense in the respective fiscal years.[315] Further, it is speculative to assume that the impact of COVID-19 18 related restrictions will diminish completely in the FTY and FPFTY and the Company will be able to spend entire budgeted amount in those periods.[316] Therefore, in the absence of information about COVID-19 related impacts on contracting and material expenses in 2019-20 and the potential impact of COVID-19 on the FTY and FPFTY expenses, I&E asserts that its recommendation based on an average of the last three years' expense is reasonable and an appropriate basis for determining the FPFTY allowance for the contracting and materials expense.[317] I&E MB at 28-29; I&E RB at 19-20.

c. Outside Services (Including Exelon Business Service Company Charges)

I&E recommended an allowance of $13,437,856 or a reduction of $3,134,144 ($16,572,000 - $13,437,856) to the Company's claim for outside services net of the "cost to

[311] PECO St. No. 2-R, p. 19.
[312] I&E St. No. 1-SR, p. 34.
[313] *Id.*
[314] *Id.*
[315] I&E St. No. 1, p. 39.
[316] I&E St. No. 1-SR, p. 34.
[317] I&E St. No. 1, p. 40; I&E St. No. 1-SR, pp. 34-35.

achieve" adjustment of $370,000.[318] I&E's recommendation for outside services is based on forecasted CPI inflation factors for the FTY and FPFTY in contrast to the Company's speculative and unsupported significant increase of 26.55% from the HTY to the FTY claim, and an additional 4.57% increase from the FTY to the FPFTY claim.[319] I&E MB at 29; I&E RB at 20.

The Company argues that the FPFTY claim for total Exelon Business Services Co. (EBSC) charges is $22,000,000 and the FTY claim of $21,000,000 is lower than the historic three-year average; therefore, the FPFTY claim for EBSC is consistent with the historic three-year average.[320] Then, PECO clarifies that the FPFTY outside services expense claim of $16,572,000 (FERC Account 923) represents a combination of: (a) EBSC contracting charges (a subset of total EBSC charges); and (b) PECO contracting charges, allocated to FERC Account 923.[321] Finally, the Company argues the Commission has repeatedly accepted the use of inflation factors as a reasonable method to derive the pro forma levels of operating expense items that were not otherwise separately adjusted for specifically known changes in costs or activity levels.[322] I&E MB at 29-30; I&E RB at 20.

I&E asserts that the Company is attempting to justify the unsupported significant increase of 26.55% in the FTY over the HTY (2019-20) actual expense, and an additional 4.57% increase up to the FPFTY claim for outsides services expense, by comparing the FPFTY total EBSC cost with the historic three-year average of EBSC costs. But the reality is that PECO had been experiencing a declining trend in both the EBSC costs and the contracting service costs for the three years prior to the FTY.[323] The FPFTY EBSC claim of $15,290,000 is higher by 15.53% over the historic three-year average of $13,234,000.[324] Similarly, the FPFTY contracting service claim of $726,000 is higher by 15.79% over the historic three-year average of $627,000.[325] Additionally, PECO's FPFTY outside services (Account 923) claim of

318 I&E St. No. 1, p. 20; I&E St. No. 1-SR, p. 17.
319 *See* I&E St. No. 1, pp. 20-22.
320 *See* PECO St. No. 2-R, pp. 16-17.
321 *See* PECO St. No. 2-R, p. 17.
322 *Id.*
323 *See* I&E St. No. 1-SR, pp. 15-16 (*See also* Table, p. 16).
324 *Id.*
325 *Id.*

$16,572,000 ($16,942,000 - $370,000 (cost to achieve)) is unchanged and is a part of the total O&M expense claim of $466,639,000 shown in the computation of the revised revenue requirement.[326] Therefore, the Company's assertion of reasonableness is not convincing. I&E MB at 30; I&E RB at 21.

I&E also notes that it is not disputing the use of inflation factors, in general, to determine a proforma expense allowance. But, in this instance, the Company neither specified what inflation factors were used, nor provided calculations, to justify and support the 26.55% increase in the FTY and the additional 4.57% increase in the FPFTY claims for outside service.[327] I&E MB at 31.

In consideration of the above and the record evidence presented by I&E, I&E asserts and recommends that adjusting the HTY actual outside services for inflation based on the Consumer Price Index (CPI) factors of 2.75% and 2.03% to determine the FTY and FPFTY allowance is fair and reasonable despite the decline in actual outside services expense by 3.17% in 2018-19 and 15.40% in 2019-20.[328] I&E MB at 31; I&E RB at 21.

d. Other Post-Employment Benefits Expense

I&E recommended an allowance of $270,000, or a reduction of $780,000 ($1,050,000 - $270,000) for OPEB expense.[329] I&E's recommendation is based on continuing the FTY claim as the FPFTY allowance because the Company's projected increases in the FTY and FPFTY claims are based on assumptions, which are not supported.[330] Therefore, the significant increase of 74.28% in the FPFTY expense claim over the FTY expense claim is not supported, nor reasonable, or reliable.[331] I&E MB at 31; I&E RB at 21-22.

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326 I&E St. No. 1-SR, p. 16, *citing* PECO Exh. MJT-1 Rev., Sch. A-1, p. 1 and Sch. D-4, p. 56.
327 I&E St. No. 1-SR, p. 17.
328 I&E St. No. 1, pp. 20-22; I&E St. No. 1-SR, p. 17.
329 I&E St. No. 1, p. 43.
330 I&E St. No. 1-SR, p. 37.
331 *See* I&E St. No. 1, pp. 43-44; I&E St. No. 1-SR, p. 37.

The Company argues that the OPEB plan design change resulted in a re-measurement of the Company's OPEB obligation, which resulted in a prior service credit recorded to other comprehensive income.[332] The prior service credit was then amortized over the remaining service life of the active plan participants (approximately seven years).[333] The increase in OPEB costs from the HTY to FTY is due to the expiration of the prior service credit in 2021, along with the attendant amortization (PECO Statement No. 2-R, p. 27).[334] Concluding, I&E's use of an FTY expense level for the FPFTY is unreasonable as the FTY expense reflects a prior service credit.[335] I&E MB at 31-32.

I&E argues that the Company's arguments, are not supported by the information provided by the Company.[336] The Company's assertion that the prior service credit amortization reduced OPEB expense in the historic fiscal years 2017-18, 2018-19, 2019-20, and partially in the FTY, but the Company's discovery responses did not provide a calculation showing the amount of the prior year service credit adjusted in the historic years and in the FTY projection.[337] Additionally, the projected OPEB expense claims of $270,000 in the FTY and $1,050,000 (a 74.28% increase over the FTY claim) in the FPFTY were derived from the calendar year OPEB cost assumption and the Company's responses did not include the basis of the cost assumption, nor its calculation, or the service credit adjustment in the historic fiscal years and in the FTY and FPFTY for gas operations.[338] Further, the actuarial report of Willis Towers Watson, provided by the Company to support the OPEB claim, does not specify a service credit adjustment.[339] In the absence of detailed information about the service credit adjustments reflected in the OPEB costs of the last three fiscal years and the adjustments made in the FTY and FPFTY OPEB claims, I&E's recommendation based on the FTY claim amount is appropriate and reasonable.[340] I&E MB at 32-33; I&E RB at 22.

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332 PECO St. No. 2-R, p. 27.

333 *Id.*

334 *Id.*

335 *Id.*, p. 28.

336 *See* I&E St. No. 1-SR, pp. 38-39.

337 I&E St. No. 1-SR, pp. 38-39, *citing* I&E Exh. No. 1, Sch. 10, pp. 1-5.

338 *Id.*

339 I&E St. No. 1-SR, p. 39, *citing* PECO Exh. RJS-4-R Confidential, p. 16.

340 I&E St. No. 1-SR, p. 39.

In consideration of the above and the record evidence presented by I&E, I&E recommends an allowance of $270,000 and accordingly, a reduction of $780,000 to PECO's claim of $1,050,000 for OPEB expense.[341] I&E MB at 33.

e. Costs to Achieve Exelon /PHI Merger

I&E recommends disallowance of the $370,000 cost to achieve expense adjustment in its entirety, which was included in the FPFTY outside services expense claim.[342] I&E makes this recommendation because the Company's claim for recovery of historic merger cost results in a retroactive recovery in rates in the absence of the Commission's prior permission to defer the merger related costs for ratemaking purposes.[343] Additionally, the merger costs were incurred during 2016 through 2018, prior to the HTY and the offsetting merger related savings were also realized in prior years.[344] Furthermore, and telling, the Company has not proposed retroactive sharing of those savings with ratepayers.[345] I&E MB at 33; I&E RB at 22-23.

The Company argued that I&E's assertion regarding prohibition for claiming an amortization of prior period merger costs (cost to achieve) unless PECO first obtained permission to "defer" such costs is a legal issue.[346] Second, PECO argued that there are exceptions to the rule against retroactive and single-issue ratemaking that could permit PECO to make its claim without having to rely upon a pre-approved "deferral" of historic period costs.[347] Lastly, the Company asserted that the cost to achieve represents an investment that will produce significant merger-related savings in PECO's distribution costs, which would continue to benefit its customers.[348] I&E MB at 34.

I&E disagrees with the Company's assertions and reiterates that the Company did not request or receive permission to defer the prior period merger related costs for ratemaking

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341 *See* I&E St. No. 1pp. 43-44; I&E St. No. 1-SR, p. 39.
342 I&E St. No. 1, p. 24.
343 I&E St. No. 1, pp. 23-25; I&E St. No. 1-SR, p. 18.
344 *Id.*
345 *Id.*
346 I&E St. No. 1-SR, p. 18-19, *citing* PECO St. No. 2-R, pp. 13-14.
347 *Id.*
348 *Id.*

purposes and all those costs were incurred during 2016 through 2018 prior to the HTY.[349] Therefore, the recovery of these costs in this proceeding is inappropriate and would result in a retroactive ratemaking.[350] Further, PECO's claim in this instance does not fall within any exception to the general rule against retroactive ratemaking as it was not unanticipated or extraordinary.[351] I&E MB at 34; I&E RB at 23.

Additionally, I&E reiterates that the merger related savings of approximately $4.30 million were already realized in prior years and the Company has not proposed retroactive sharing of those savings with the ratepayers.[352] Most importantly, the Company has already saved, at a minimum, $0.5 million in 2016, $0.9 million in 2017, $0.9 million in 2018, $1.00 million in 2019, and $1.00 million in 2020, aggregating $4.30 million in the last five years[353], which is enough money to cover the entire cost to achieve merger savings.[354] However, the Company is seeking recovery of prior period total merger cost of $1,111,000 over a three-year amortization period, which is unsupported, inappropriate and unreasonable.[355] Accordingly, I&E recommends a disallowance of the $370,000 ($1,111,000 ÷ 3) costs to achieve expense claim in its entirety.[356] I&E MB at 34-35; I&E RB at 24.

f. Regulatory Commission Expenses/General Assessments

I&E did not brief this specific issue.

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349 I&E St. No. 1-SR, p. 19, *citing* I&E St. No. 1, p. 24; I&E Exh. No. 1, Sch. 5, pp. 1-2.

350 *See generally*, *National Fuel Gas Distribution Corp. v. Pa. Pub. Util. Comm'n*, 76 Pa. Commw. 102, 464 A.2d 546 (1983) (A utility may not receive retroactive rate relief on account of expense items which are greater than anticipated or of revenue items which are lesser. It is sensible because consideration of expense items in isolation and the requirement of refunds based only on such narrow consideration could result in the setting of confiscatory rates. *Id.*, at 147, 464 A.2d 567).

351 *Id.*

352 I&E St. No. 1-SR, p. 19.

353 *See* I&E St. No. 1, p. 24, *citing* I&E Exh. No. 1, Sch. 5, pp. 3-4.

354 I&E St. No. 1-SR, p. 19.

355 I&E St. No. 1, p. 24; I&E St. No. 1-SR, p. 19.

356 I&E St. No. 1, pp. 24-25; I&E St. No. 1-SR, p. 20.

g. Research and Development Expenses

I&E did not brief this specific issue.

h. Employee Activity Costs

I&E recommended an allowance of $58,469, or a reduction of $80,933 ($139,402 - $58,469) to the Company's claim for employee activity costs.[357] I&E recommended disallowance of the Company's sponsored employee picnic and celebration expenses of $80,933 from the total claim of $139,402 because these expenses are not necessary for the provision of safe and reliable gas service to ratepayers.[358] I&E MB at 37.

The Company argued that PECO's annual picnic claim is based on a range of activities that are relatively modest cost expenditures, which have significant benefits in terms of employee morale and productivity.[359] PECO argued that at the annual gathering of employees and other events, they celebrate workforce accomplishments, strategic goals, and initiatives for the upcoming year.[360] Therefore, the Company believes these expenses help PECO make an attractive workplace to recruit and retain talented professionals.[361] I&E MB at 37.

I&E disagrees and asserts that the Company is claiming other allowable employee activities related expenses: Employee Recognition Awards of $36,146, Employee Service Awards - Pin and small gifts of $20,884, and Employee Network Groups of $1,439 amounting in total $58,469, which I&E recognized and accepted.[362] I&E however does not believe employee picnics and celebrations are factors or tools to attract and retain talented employees.[363] Further ratepayers should not be required to fund the Company's decisions to offer special events to its

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357 I&E St. No. 1, p. 26.
358 *Id.*
359 PECO St. No. 2-R, p. 21.
360 *Id.*
361 *Id.*
362 I&E St. No. 1, p. 26.
363 I&E St. No. 1-SR, p.21.

employees and their families as it is not a reasonable or prudent expense.[364] I&E MB at 37-38; I&E RB at 25.

In consideration of the above and the record evidence presented by I&E, I&E recommends an allowance of $58,469, and accordingly, a reduction of $80,933 to PECO's claim of $139,402.[365] I&E MB at 38; I&E RB at 25.

i. Travel, Meals and Entertainment

I&E recommended an allowance of $862,153, or a reduction of $169,847 ($1,032,000 - $862,153) for travel, meals, and entertainment expense.[366] I&E's recommendation was based on applying the CPI inflation factor of 2.03% to the FTY claim to determine a FPFTY allowance, and the rejection of PECO's significant increase of 22.13% in the FPFTY claim as unsupported, speculative, and inconsistent with the Company's assertion for an increased claim due to general inflation.[367] I&E MB at 38; I&E RB at 25.

The Company argued that PECO's budgeted data for the FTY and FPFTY is more representative of the current and future conditions than the HTY (2019-20) data.[368] The Company stated the HTY data reflects COVID-19 travel restrictions that were put in place, which will be alleviated by the availability of a COVID-19 vaccine and other measures to mitigate the impact of COVID-19.[369] I&E MB at 38-39.

Nevertheless, I&E asserts that the Company claimed that the increase in the FPFTY claim of $1,032,000 from the FTY expense of $845,000 is due to inflation.[370] However, the Company's FPFTY claim is higher by 22.13% over the FTY expense, which is not consistent with the current inflation trend and the Company did not provide any additional information to

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364 *Id.*
365 I&E St. No. 1, p. 26; I&E St. No. 1-SR, p. 22.
366 I&E St. No. 1, p. 41.
367 *See* I&E St. No. 1, pp. 41-42.
368 PECO St. No. 2-R, pp. 22-23.
369 *Id.*
370 I&E St. No. 1, p. 41.

support its claim.[371] Additionally, the travel restrictions due to COVID-19 pandemic would limit the employees travel-related expenses in the FTY and FPFTY.[372] I&E, therefore, calculated its recommendation by applying a CPI inflation factor of 2.03% to the FTY expense to determine the FPFTY allowance.[373] Therefore, I&E's recommendation based on the FTY claim of $845,000 plus an inflation adjustment of 2.03% for the FPFTY expense allowance is fair and reasonable during the uncertain pandemic environment.[374] I&E MB at 39.

In consideration of the above and the record evidence presented by I&E, I&E recommends an allowance of $862,153, and accordingly, a reduction of $169,847 to PECO's claim of $1,032,000.[375] I&E MB at 39; I&E RB at 26.

j. Membership Dues

In Direct Testimony, I&E recommended an allowance of $559,304, or a reduction of $96,593 ($655,897 - $559,304) for industry organization memberships expense.[376] I&E's recommendation was based on applying the CPI inflation factor of 2.75% to the HTY actual expense of $533,505 to determine the FTY allowance of $548,176 and an additional 2.03% to the FTY allowance to determine the recommended FPFTY allowance of $559,304.[377] I&E MB at 40.

The Company argued that a significant increase in the organization memberships expense from the HTY to the FTY was due to an inadvertent omission of certain membership expenses in the HTY number that was provided in PECO's original discovery responses.[378] PECO then included these previously omitted HTY membership expenses in a revised discovery response.[379] Based on the revised response, the Company states that its industry organization

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371 *Id.*, p. 42; I&E Exh. No. 1, Sch. 9, p. 2.
372 *Id.*
373 *See* I&E St. No. 1, p. 42; I&E St. No. 1-SR, pp. 36-37.
374 I&E St. No. 1-SR, p. 37.
375 I&E St. No. 1, p. 41; I&E St. No. 1-SR, p. 37.
376 I&E St. No. 1, p. 28.
377 *See* I&E St. No. 1, pp. 28-29.
378 PECO St. No. 2-R, p. 23.
379 *Id.*

memberships expense of $647,000 in the FTY and $656,000 in the FPFTY are slightly higher than the Company's historic three-year average of $612,000 for memberships.[380] However, the Company did not categorically deny or reject I&E's application of CPI inflation factors to determine the FTY and FPFTY expense allowance.[381] I&E MB at 40.

In response, I&E provides that it appears the Company provided the corrected industry organization memberships expense of $689,986 (in lieu of $595,986) and $561,005 (in lieu of $533,505) incurred in the fiscal years 2018-19 and 2019-20 respectively in its revised response.[382] Further, PECO states that its budgeted claims for the FTY and FPFTY are largely based on general inflationary increases to industry organization memberships cost, which is not acceptable in the absence of specific information about inflation factors applied in the budgeting process to determine the FTY and FPFTY claims.[383] The result is, PECO claimed a 15.31% increase in the FTY over the HTY expense and a 1.39% increase in the FPFTY over the FTY expense.[384] But, these increases are speculative and unreliable because they are not consistent with acceptable inflation rates.[385] I&E MB at 41.

Based on PECO's revised HTY expense, I&E calculated its updated recommendations for the FTY and FPFTY membership expense;[386] and, in consideration of the above and the record evidence presented by I&E, I&E recommends an updated allowance of $588,135, and accordingly, a reduction of $67,762 ($655,897 - $588,135) to PECO's industry organization membership expense claim of $655,897.[387] I&E MB at 41; I&E RB at 26.

k. Injuries and Damages

I&E did not brief this specific issue.

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380 *Id.*
381 *See* I&E St. No. 1-SR, pp. 23-25.
382 *See* I&E St. No. 1-SR, p. 23; I&E Exh. No. 1-SR, Sch. 1, pp. 1-2.
383 *See* I&E St. No.1, p. 28.
384 I&E St. No.1-SR, p. 24.
385 *Id.*
386 I&E St. No. 1-SR, p. 24.
387 I&E St. No. 1, pp. 28-29; I&E St. No. 1-SR, p. 25.

l. Property Taxes

I&E did not brief this specific issue.

m. Energy Efficiency and Conservation Program Costs

I&E recommended an allowance of $2,727,500, or a reduction of $1,772,500 ($4,500,000 - $2,727,500) to the expanded EE&C program cost.[388] I&E's recommendation was primarily based on the limited historic success rate of PECO's current rebate programs and other reasons discussed by I&E witness Patel.[389] I&E MB at 43.

The Company acknowledged that past customer participation levels have not met projections and that program expenditures have been less than the budgeted amounts.[390] The Company then argued that the Company's proposed budget will support both the expanded program offerings as well as the development and execution of campaigns to promote natural gas efficiency rebates. Adding that the campaigns will focus on the economic benefits of purchasing more-efficient equipment and will be directed to rebate programs, targeted customer markets, and engaging trade allies.[391] Further, PECO states that there has been a 9% increase in Energy Star™ rebates from 2019 to 2020 and comparing the fourth quarter of 2019 with the fourth quarter of 2020, the Company has seen a 16% increase in Energy Star™ rebates.[392] I&E MB at 43-44.

In response, I&E offers that it continues to recommend that the Company should accommodate new program costs within I&E's recommended allowance of $2,727,500 for the expanded EE&C program cost because PECO has experienced significant unspent EE&C funding at an average 43.24% of annual customer funding for the EE&C program during the last three fiscal years, which was required to be refunded back to the customers.[393] Additionally,

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388 I&E St. No. 1, p. 34.
389 I&E St. No. 1, pp. 34-37.
390 PECO St. No. 9-R, p 4.
391 PECO St. No. 9-R, pp. 4-5.
392 *Id.*, p. 5.
393 I&E St. No. 1, pp. 34-35.

despite the fact that the Company's EE&C program has operated since 2010-11 and with continuous customer outreach and education spending, the Company achieved merely 3,501 customers' participation (an average of the last three fiscal years) out of approximately 534,000 retail customers.[394] Further, though, the Company has projected significantly higher number of 27,739 customers' participation in the FPFTY EE&C program,[395] the Company's projected customer participation is speculative, unreasonable, and not supported by historic participation levels.[396] Therefore, the budgeted/expanded EE&C program cost is flawed and not prudent nor reliable.[397] I&E MB at 44-45.

I&E further notes that natural gas prices are at historic lows; thus, usage reductions will not translate into significant annual savings to individuals implementing energy conservation measures and the increased cost of the higher efficiency equipment options will have long payback periods.[398] Arguably, investing in energy efficient equipment even after rebates would not incentivize additional customers to participate in the expanded EE&C program, and the Company may find it very challenging to convince ratepayers to make upgrades under the proposed expanded EE&C program.[399] Quite simply, the speculation that a 16% increase in Energy Star™ rebates in the fourth quarter of 2020, as compared with the fourth quarter of 2019, supports PECO's inflated customer participation forecasts and the Company's request for a significantly increased FPFTY claim of $4,500,000 (a 65% increase) for the expanded EE&C programs in contrast to the current program cost of $2,727,500 is not reasonable, prudent, nor supported. I&E MB at 45; I&E RB at 27.

In consideration of the above and the record evidence presented, I&E continues to recommend an allowance of $2,727,500, and accordingly, a reduction of $1,772,500 to PECO's claim of $4,500,000.[400] I&E MB at 45.

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394 I&E St. No. 1-SR, p. 30, *citing* PECO St. No. 1, p. 2.
395 *See* PECO Exh. DLM-1 Rev.; DLM-2 Rev.
396 I&E St. No. 1-SR, pp. 29-32.
397 *Id*.
398 *Id.*
399 *Id.*, pp. 30-31.
400 I&E St. No. 1, p. 34; I&E St. No. 1-SR, p. 32.

n. Rate Case Expense Normalization

I&E recommended an allowance of $311,800 (($1,559,000 ÷ 60 months) x 12 months), or a reduction of $208,200 ($520,000 - $311,800) to the Company's FPFTY claim.[401] The I&E recommendation to normalize rate case expense over a period of 60 months (five years) was based on PECO's historic rate case filing frequency in contrast to PECO's request for a 36-month amortization period.[402] I&E MB at 46.

The Company argued, as they are incentivized to do regardless of how long it has been since they have been in for a base rate increase, that PECO will need to file another rate case in three years (a 36-month period) because the Company will need to invest approximately $1.2 billion in new and replacement gas utility plant between July 1, 2020 and June 30, 2024.[403] Therefore, the Company used the normalization period of three years for rate case expense.[404] Further, the Company mentioned the 2012 PPL Electric Utilities Corporation (PPL Electric) and the 2017 UGI Utilities, Inc. - Electric Division (UGI Electric) rate cases in support of the Company's argument that rate case normalization periods should not be backward looking but should reflect the future expectations and suggesting the Commission affirmed that practice for determining the normalization period for rate case expense.[405] I&E MB at 46.

I&E disagrees with PECO's claimed 36-month normalization period and maintains that it is not supported by the Company's historic filing frequency; and, the proposed normalization period fails to properly rely upon the historic data, and the claimed period is speculative in nature.[406] Further, PECO ignores the Commission's orders in the *Emporium Water Company*[407] base rate case; the *City of DuBois*[408] base rate case, and most recently the

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401 I&E St. No. 1, p. 8.
402 *See* I&E St. No. 1, pp. 8-11.
403 PECO St. No. 3-R, p. 22.
404 *Id.*
405 PECO St. No. 3-R, p. 23.
406 *See* I&E St. No. 1, pp. 8-11.
407 *See Pa. Pub. Util. Comm'n v. Emporium Water Co.*, Docket No. R-2014-2402324, p. 50 (Order Entered January 28, 2015).
408 *See Pa. Pub. Util. Comm'n v. City of DuBois - Bureau of Water*, Docket No. R-2016-2554150, pp. 65-66 (Order Entered March 28, 2017) and *Pa. Pub. Util. Comm'n v. City of DuBois - Bureau of Water*, Docket No. R-2016-2554150, p. 13 (Order Entered May 18, 2017).

Columbia Gas[409] base rate case where the Commission found in favor of I&E's recommendation for a normalization period based on the actual historic filing frequency, which is more reliable than the future speculation or simple stated intention to file a rate case.[410] I&E MB at 46-47.

In consideration of the above and the record evidence presented, I&E continues to recommend a 60-month normalization period for rate case expense, and accordingly, a reduction of $208,200 to PECO's claim of $520,000.[411] I&E MB at 47.

o. Regulatory Initiatives

I&E recommended an allowance of $451,600, or a reduction of $301,400 ($753,000 - $451,600) to the regulatory initiative cost claim.[412] The I&E recommendation is based on a five-year amortization period in contrast to the Company's claimed three-year amortization for regulatory initiative costs.[413] I&E MB at 47.

In response to I&E's recommendation, PECO revised the FPFTY claim for its regulatory initiative cost from $753,000 to $47,000 due to the elimination of gas neighborhood pilot program cost recovery of $706,000.[414] However, the Company is continuing to claim $47,000 ($141,000 ÷ 3 years) based on the amortization of gas unbundling of GPC/MFC charges deferred in prior years for future recovery.[415] Further, the Company continues to argue that a five-year amortization of this expense is unreasonable and should be rejected because the Company's proposed three-year amortization is consistent with three-year normalization period claimed for rate case expense, which is reasonable and should be adopted.[416] I&E MB at 48.

409 *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa. Inc.,* Docket No. R-2020-3018835, p. 78 (Order Entered February 19, 2021).
410 I&E St. No. 1, p. 10; I&E St. No. 1-SR, p. 7.
411 I&E St. No. 1, p. 8; I&E St. No. 1-SR. p. 7.
412 I&E St. No. 1, p. 31.
413 *See* I&E St. No. 1, pp. 29-31.
414 PECO St. No. 3-R, p. 24. *See also* PECO Exh. MJT-1 Rev., Sch. D-14, p. 75.
415 *Id.*
416 PECO St. No. 3-R, p 24.

Nevertheless, I&E continues to recommend a five-year amortization period in contrast to the Company's claimed three-year amortization for this unrecovered cost.[417] A five-year amortization period is consistent with I&E's recommended normalization period of five years for rate case expense to reduce the impact of historic costs in rates.[418] Therefore, in consideration of the above and the record evidence presented, I&E recommends an updated allowance of $28,200 ($141,000 ÷ 5-year amortization), or a reduction of $18,800 ($47,000 - $28,200) to PECO's revised claim of $47,000.[419] I&E MB at 48; I&E RB at 29.

p. Manufactured Gas Plant Remediation Expense

I&E did not brief this specific issue.

q. Depreciation Expense

I&E notes that it offered its position on depreciation expense when it addressed depreciation reserve under Rate Base.

r. Cash Working Capital

I&E recommends an allowance of $2,902,236 or reduction of $320,764 ($3,223,000 22 - $2,902,236) to the Company's cash working capital (CWC) claim.[420] I&E's recommendation included modification of the Company's claim based on all recommended adjustments to O&M expenses.[421] I&E MB at 49.

The Company provided an updated FPFTY CWC claim from $3,223,000 to $3,437,000 based on changes made in components of the CWC calculation prompting an updated CWC claim.[422] I&E MB at 50.

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417 I&E St. No. 1, p. 31; I&E St. No. 1-SR, pp. 26-27.
418 *Id.*
419 I&E St. No. 1-SR, p. 27.
420 I&E St. No. 1, p. 51.
421 *See generally* I&E St. No. 1, pp. 4-53.
422 PECO St. No. 3-R, pp.2-3; PECO Exh. MJT-1 Rev., Sch C-4, p. 23.

I&E disagrees with the Company's claim and notes all O&M expense adjustments that are cash-based expense claims are included when determining the Company's overall CWC requirement.[423] Further, based on reflecting all of I&E's recommended adjustments as discussed above, I&E's updated recommendation for CWC is $3,135,234 or a reduction of $301,766 ($3,437,000 - $3,135,234) to the Company's updated claim.[424] I&E MB at 50.

Finally, I&E's updated CWC recommendation is not a final recommendation, as all adjustments to the Company's claims must be continually brought together in the Administrative Law Judge's Recommended Decision and again in the Commission's Final Order.[425] This process, known as "iteration," effectively prevents the determination of a precise calculation until all adjustments have been made to the Company's claims.[426] I&E MB at 50.

3. OCA's Position

a. Payroll and Payroll Related Expenses

The Company's claimed FPFTY payroll expense was calculated to annualize budgeted payroll expense to reflect the number of employees at the end of the FPFTY, or 638 positions, and reflect a 2.5% wage increase for both union and non-union employees forecasted to be effective on January 1, 2022 and March 1, 2022, respectively[427]. The Company also adjusted its payroll expense to increase its employee headcount by 1 more position to include a total of 639 positions.[428] The Company also normalized, over a 6-year period, a one-time cash payment to union employees made in connection with the ratification of current union contracts.[429] OCA witness Mr. Morgan adjusted the Company's FPFTY payroll expense according to his adjusted employee headcount and the elimination of past costs for a one-time bonus paid in exchange for ratification of the union contract on or before December 31, 2014.

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423 *See* I&E St. No. 1-SR, pp. 43-46.
424 I&E St. No. 1-SR, p. 46; I&E Exh. No. 1-SR, Sch. 2, p. 1.
425 I&E St. No. 1-SR, p. 46.
426 *Id.*
427 PECO Exhibit MJT-1, Schedule D-6; *see also* PECO Exh. MJT-1, Sch. D-8.
428 PECO Exh. MJT-1, Sch. D-8.
429 PECO Exh. MJT-1, Sch. D-6.

These adjustments reduce payroll expenses by $2,447,000 as presented on Schedule LKM-11. OCA MB at 44.

i. Employee Headcount

Regarding the increase in employee headcount, Mr. Morgan's recommended adjustment reduces the number of employees to 604 positions, the most recent actual number of employees, because the Company has not adequately supported the increase in the number of positions for the FPFTY.[430] OCA MB at 45.

In rebuttal, the Company's witness, Robert Stefani, disagreed with Mr. Morgan's conclusion and provided a list of positions the Company plans to fill and explained that the Company had filled 612 positions as of December 31, 2020, but did not reach its anticipated employee headcount of 635 by December 2020 due to the impacts of the COVID-19 Pandemic.[431]

As concluded by Mr. Morgan in his testimony,[432] the Company did not reach its projected forecasted headcount and the supplemental comparison provided by the Company in rebuttal should not be accepted as proper proof of the gap between the actual and projected number of employees because of the misleading effect of the inclusion of allocated employees in the number of projected employees.[433] Additionally, the Company claimed that 37 additional employees would be hired during the HTY and FPFTY and the Company only provided information on and the job descriptions of the employees hired during the HTY.[434] The Company further did not provide management approval documentation for the positions the Company claims it will eventually fill.[435] As Mr. Morgan explains, other companies have been

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430 OCA St. 2 at 23-24.
431 PECO St. 2-R at 11; OCA St. 2-SR at 16.
432 OCA St. 2-R at 16.
433 *Id.*
434 *Id*. at 17.
435 *Id.*

able to provide management approval documents to substantiate their future hiring claims.[436] OCA MB at 45-46.

Recently, in the *Columbia Gas* decision, the Commission adjusted Columbia's projected employee headcount according to its actual hiring experience.[437] Similarly, PECO's projected employee headcount is not supported or reflective of the Company's actual hiring experience. For these reasons, the Company did not provide proper support for its increased employee headcount and the Commission should accept the OCA's reasonable adjustment, which reflects the Company's historic data and actual hiring experience. The Companies salaries and wage claim, therefore, should be adjusted by $2,447,000 as presented on Schedule LKM-11. OCA MB at 46.

ii. One-time Cash Payment for Ratification of the Union Contract

In addition to reducing the employee headcount to reflect the Company's actual and supported hiring data, Mr. Morgan removes the normalization of the one-time cash payment for ratification of the union contract because it is a prior period cost, and recovery would constitute retroactive ratemaking and violate normal ratemaking principles.[438]

In rebuttal, the Company's witness Mr. Trzaska claims that it is a Commission practice to spread expenses like this over the average length of the Company's collective bargaining agreements.[439] However, Mr. Morgan responds by indicating that expenses like the one-time bonus payment to union employees each time it negotiates new union contracts remains a past expense payment for past employee action and that "[t]he future collection of a prior period cost is the definition of retroactive ratemaking."[440] Mr. Morgan also indicates that the Company admitted that the past payment was not connected to any requirement of the employees

436 *Id.*
437 *Columbia Gas* at 71.
438 OCA St. 2R at 25.
439 PECO St. 3-R at 21.
440 OCA St. 2-SR at 18.

by stating "[t]here were no specific future tasks, service or obligations that were expected from those who received the one-time payment"[441] OCA MB at 47.

The Commonwealth Court has held:

> Ratemaking, by its nature, is prospective. Typically, a utility files a general rate case with a record of revenues and expenses for the past year and a projection of anticipated expenses and revenues for a future test year. . . .
>
> Because of the prospective nature of rates, a rule against retroactive ratemaking has developed. <u>The rule against retroactive ratemaking prohibits a public utility commission from setting future rates to allow a utility to recoup past losses or to refund to consumers excess utility profits</u>. The policy reasons behind this rule are that if retroactive ratemaking is allowed, it makes the "test year" method of ratemaking meaningless and the general principle that those customers who use power should pay for its production rather than requiring future ratepayers to pay for past use.[442]

The Company's attempt in this case to recover in the FPFTY the bonus payments made in 2015 violates the rule against retroactive ratemaking and, therefore, should be excluded from its payroll expense claim as recommended by Mr. Morgan. OCA MB at 47-48.

b. Contracting and Materials Expense

The Company increased the FPFTY amount for Contracting Services and Contracting Professionals (contracting and materials expense) by approximately $400,000 over the HTY amount in the aggregate.[443] OCA witness Morgan testified that the Company did not offer a specific reason to attribute to the increase.[444] Upon request for more information on the source of the increase, the Company provided a broad response that lacked data related to the inflation adjustment provided by the Company.[445] Accordingly, OCA Witness Morgan

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441 *Id.*

442 *Popowsky v. Pub. Util. Comm'n*, 642 A.2d 648, 650-51 (Pa. Commw. Ct. 1994) (internal citations omitted, emphasis added) (Court held that a utility may not recover, in a future base rate case, costs that were previously and incrementally incurred due to changes in accounting standards) (citations omitted).

443 PECO St. 3, Exhibit MJT-1, Schedule D-4, pp. 55-56.

444 OCA St. 2 at 39.

445 OCA St. 1 at 39.

concluded that the specifics of the inflation adjustment are unknown and should not be accepted by the Commission. OCA MB at 48-49.

Mr. Morgan testified further to his disagreement with the Company's use of an inflation factor to calculate Contracting expenses for the same reason it was inappropriate to utilize in the calculation of the Company's Exelon Business Service Company (EBSC) charges, Regulatory Commission expenses, and Property Taxes. The Commission has previously found the use of a blanket inflation adjustment to be inappropriate because it does not directly relate to the actual costs expected to be incurred in each expense account in the FPFTY.[446] As in the case of all of these adjustments, Mr. Morgan testified to the inappropriateness of using an inflation adjustment for these expenses.[447] The Company's inappropriate use of a blanket inflation adjustment for contracting and material expenses is part of the reason Mr. Morgan concluded that the Company has used an abbreviated approach to developing the FPFTY expenses.[448] As a result, Mr. Morgan recommended an adjustment to reflect the most recent actual 3-year average level of contracting expenses, reducing O&M expenses by $367,000 as shown on Schedule LKM-23. OCA MB at 49-50; OCA RB at 24-25.

As previously noted, PECO witness Stefani offered rebuttal testimony explaining that its projected contracting professionals and services expense increases in the FTY and FPFTY are driven by the same factors attributed to the increase in contracting and materials expenses.[449] Although the reasons provided by the Company in rebuttal attempted to provide a bit more clarity regarding the basis for the increase, the Company has still failed to demonstrate or quantify the true increase in costs that would result from those actions. Even though the Company, in rebuttal, could identify specific projects, it has chosen to use an abbreviated approach by applying an inflation escalation rather than price out the cost of the projects. For that reason, and for the reasons provided above regarding the inappropriate use of blanket inflation adjustments, the OCA maintains that Mr. Morgan's calculation to reflect the most

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446 *See Pa. Pub. Util. Comm'n v. Wellsboro Elec. Co.*, Docket No. R-2019-3008208 (Opinion and Order entered April 29, 2020) at 40 (*Wellsboro 2020*).

447 OCA St. 2 at 39-40.

448 *Id*.

449 PECO St. 2-R at 19.

recent actual 3-year average level of contracting expenses, reducing O&M expenses by $367,000 as shown on Schedule LKM-23, is reasonable and should be accepted by the Commission. OCA MB at 50; OCA RB at 26.

c. Outside Services (Including Exelon Business Service Company Charges)

The Company increased FPFTY EBSC charges by approximately $1,600,000 over the HTY.[450] In his direct testimony, OCA witness Morgan recommended an adjustment to EBSC charges because he disagreed with the use of inflation escalations as the basis of the increase in costs.[451] Mr. Morgan testified that inflation adjustments are typically blanket adjustments or increases which do not directly relate to actual costs expected to be incurred by the Company in the period in which rates are to be set.[452] OCA MB at 50-51.

The OCA asserts that the Company was not able to provide a specific reason to attribute to the cause of the increase.[453] Instead, when the Company was asked to explain the cause of the increase, it responded by stating that "[b]udgeted increases in the relevant line item of the allocated expenses are generally due to inflation and any MMF rate adjustments."[454] However, "[i]t is unknown what the MMF rate adjustment could be because the Company did not provide the information requested. The lack of data here (as well as for other expenses) is part of the reason [Mr. Morgan] concluded that the Company has used an abbreviated approach to develop the FPFTY expenses."[455] OCA MB at 51.

Mr. Morgan also disagreed with the use of adjustments based on inflation escalations for this expense "because they are not actually known and measurable."[456] Mr. Morgan testified that the adjustments "do not reflect the anticipated cost of expenses and are inconsistent with the Company's claim that the annual budgeting and planning process is

450 OCA St. 2 at 36.
451 OCA St. 2 at 36–37.
452 OCA St. 2 at 36–37. *See also Wellsboro 2020* at 40.
453 OCA St. 2 at 36.
454 OCA St. 2 at 36 (quoting PECO Response to IE-RE-11-D(E)).
455 OCA St. 2 at 36.
456 OCA St. 2 at 36.

designed 'to integrate and align PECO's operational, regulatory, and financial plans.'"[457] Mr. Morgan recommended "an adjustment to reflect the most recent 3-year average EBSC expense," which results in an adjustment to reduce O&M expenses by $997,000.[458] OCA MB at 51-52.

Mr. Morgan derived his EBSC calculation using the Company's data in PECO Exh. RJS-1 and Attachment III-A-22(a). That is, the Company's total claim for EBSC costs in this proceeding is $22 million.[459] Of that $22 million, approximately $10 million is related to non-IT costs and includes costs related to Communication, Executives, Utilities, Finance, Government Affairs, Human Resource, Legal Governance, Security, Supply, etc., which are based on an inflation adjustment.[460] Thus, Mr. Morgan's adjustment normalizes the non-IT costs to reflect a three-year average of historic spending for those specific costs. In other words, Mr. Morgan does not adjust the Company's claim for EBSC related IT-costs of $12.1 million as claimed in Exh. RJS-1. OCA RB at 27.

In PECO witness Stefani's rebuttal testimony, he argued that the FPFTY expenses are appropriate because Counsel for the Company "advised him that the Commission has repeatedly accepted the use of inflation factors as a reasonable method to derive the pro forma levels of operating expense items that were not otherwise separately adjusted."[461] However, Mr. Morgan determined that the Company did not meet "its burden in demonstrating that its proposed blanket inflation escalation to a diverse group of expenses would meet the 'known and measurable' standard for increasing each expense claim in the FPFTY."[462] OCA MB at 52.

The OCA concludes that because the resulting amounts do not meet the known and certain standard in this instance, the OCA recommends that the Commission reject the Company's projections for EBSC costs.[463] The OCA finds that "[p]roperly budgeted data would have been based on integrating and aligning PECO's operational, regulatory, and financial plans,

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457 OCA St. 2 at 36.
458 OCA St. 2 at 36–37, Sch. LKM-20.
459 PECO St. 2 at 21; *see also* PECO Exh. RJS-1.
460 *See* OCA St. 2 at 36.
461 OCA St. 2-SR at 21 (citing PECO St. 2-R at 17).
462 OCA St. 2-SR at 21–22. *See also Wellsboro 2020* at 40.
463 OCA St. 2-SR at 22.

and would have been more accurate."[464] Accordingly, the OCA argues that the Commission should adopt Mr. Morgan's adjustment to reflect the most recent 3-year average EBSC expenses, which results in an adjustment to reduce O&M expenses by $997,000.[465] OCA MB at 52-53; OCA RB at 28.

d. Other Post-Employment Benefits Expense

OCA witness Morgan testified that Company's claimed post-retirement benefits expense of $1,050,000 represents a significant increase from the HTY to the most recent actual 3-year average.[466] Mr. Morgan further testified that he could not locate the source of the Company's OPEB expense claim and, therefore, adjusted the Company's OPEB expense to reflect the most recent actual 3-year average.[467] As a result of this adjustment, the Company's OPEB expense was originally reduced by $1,085,000 as presented on Schedule LKM-13. OCA MB at 53.

In rebuttal, Mr. Stefani explained that the increase in OPEB expense is a result of an expiring service credit amortization in 2021-2022.[468] Mr. Stefani also provided, in rebuttal, PECO Exhibit RJS-4-R CONFIDENTIAL, which shows the Company's OPEB costs in recent years. Using the data presented in that document, Mr. Morgan recalculated his OPEB expense adjustment based upon the 3-year average (2020 to 2022) of OPEB costs resulting in a downward adjustment of $486,000 from the Company's OPEB claim of $1,050,000 presented on CONFIDENTIAL Surrebuttal Schedule LKM-13.[469] The OCA submits that Mr. Morgan's recalculation should be adopted because it is based upon the Company's recent 3-year average of OPEB costs and accounts for the service credit amortization expiration in 2021-2022. These types of adjustments are appropriate where they occur regularly, but in irregular amounts.[470] OCA MB at 53-54.

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464 OCA St. 2-SR at 22.
465 OCA St. 2 at 36–37, Sch. LKM-20.
466 OCA St. 2 at 26-27.
467 *Id.*
468 PECO St. 2-R at 25-28.
469 *See* OCA St. 2-SR, Sch. 3, Pg. 1, Line 6.
470 *See Pa. Pub. Util. Comm'n. v. Total Environmental Solutions, Inc.,* Docket No. R-00072493, *et al*., 2008 Pa. PUC LEXIS 42 at *98 (Pa. PUC May 23, 2008) (*TESI 2007*).

Accordingly, the OCA requests that the Commission adopt the adjustment of OCA witness Morgan to normalize the Company's OPEB expense over the 3-year period (2020-2022), resulting in a downward adjustment of $486,000 from the Company's OPEB claim.[471] OCA MB at 54; OCA RB at 29.

e. Costs to Achieve Exelon /PHI Merger

The Company claimed $1,111,000 over 3 years, or $370,000 for the FPFTY, for the costs related to the merger between Exelon—PECO's parent company—and Pepco Holdings Corporation, a holding company for a non-Pennsylvanian public utility, that took place in 2016.[472] According to the Company, this merger brought $4.3 million worth of savings to PECO over the last 5 years and the Company believes it should recover the costs of the merger in this present rate proceeding.[473] OCA witness Mr. Morgan testified that this prior cost incurred in 2016 was not authorized to be deferred by the Commission and recommended that the costs to achieve expense be rejected in full because to include it in rates would constitute retroactive ratemaking.[474] OCA MB at 54.

In rebuttal, the Company's witness Mr. Stefani stated that the exclusion of these costs would be unfair given the savings the merger has brought to customers by reducing costs.[475] In response, Mr. Morgan indicated that the savings PECO has generated from the merger have been retained by the Company and PECO's customers have not experienced reduced rates as a result of the merger.[476] Similar to the Company's claimed expenses for the one-time union bonus payments made in 2015 as discussed previously, the inclusion of these past costs, without previously gaining from the Commission the permission to defer them, violates the rule against retroactive ratemaking and should, therefore, be excluded from FPFTY

471 *See* OCA St. 2-SR, Sch. 3, Pg. 1, Line 6.
472 PECO St. 3 at 40-41; *see also*, MJT-1 Schedule D-15.
473 *Id*.
474 OCA St. 2 at 33-36.
475 PECO St. 2-R at 14.
476 OCA St. 2-SR at 20.

rates. As a result, the Commission should deny the Company's claim to recover the cost of the 2015 merger and reduce the Company's O&M expense by $370,000.[477] OCA MB at 54.

f. Regulatory Commission Expenses/General Assessments

The Company increased FPFTY Regulatory Commission expense by approximately $462,000 over the HTY.[478] However, OCA witness Morgan disagreed "with the use of adjustments based on inflation escalations.[479] Mr. Morgan again argues that adjustments based on inflation escalations are not actually known and measurable."[480] OCA MB at 55.

The OCA maintains that the Company did not "provide a specific reason to attribute the cause of the increase."[481] When the Company was asked to explain the cause of the increase, it responded by stating that "[t]he projected increases in regulatory commission expense are generally due to inflation adjustments."[482] However, "[t]he specifics of the inflation adjustment are unknown because the Company did not provide the information requested. The Company's use of an abbreviated approach to develop the FPFTY expenses appears to contribute to the lack of data here."[483] OCA MB at 55.

Mr. Morgan disagrees "with the use of adjustments based on inflation escalations because they are not actually known and measurable."[484] Mr. Morgan testified that adjustments based on inflation escalations "do not reflect the anticipated cost of expenses and are inconsistent with the Company's claim that the annual budgeting and planning process is designed 'to integrate and align PECO's operational, regulatory, and financial plans.'"[485] Mr. Morgan stated that "[i]nflation adjustments are typically blanket adjustments or increases which do not directly relate to actual costs expected to be incurred by the Company in the period in which rates are to

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477 *See* OCA St. 2-SR, Sch. LKM-19.
478 OCA St. at 38.
479 OCA St. 2 at 38.
480 OCA St. 2 at 38.
481 OCA St. 2 at 38.
482 OCA St. 2 at 38 (quoting PECO Response to IE-RE-15-D(B)).
483 OCA St. 2 at 38.
484 OCA St. 2 at 38. *See also Wellsboro 2020* at 40.
485 OCA St. 2 at 38.

be set."[486] Instead, Mr. Morgan recommended that projected costs be based "upon evidence or documentation that show the specific actions and program that underlie the Company's adjustments."[487] Mr. Morgan does not believe that "the determination of expenses for the FPFTY was envisioned to be simply applying an inflation rate to expenses" when Act 11 was implemented.[488]

The OCA further argues that the Company's claim that its general assessments will increase by 16.6% between the FTY and FPFTY is speculative and not supported by evidence. Pursuant to Section 510 of the Public Utility Code, the general assessment for Commission operations can fluctuate from year to year depending on the Commission's budget and how that budget is allocated across each group of utilities.[489] Thus, any increase in general assessments between the HTY and FTY is not indicative of future increases. Rather, OCA witness Morgan reasonably adjusted the Company's claims to remove an inflation adjustment that is not supported by evidence and has previously been disallowed by the Commission. OCA RB at 32.

Therefore, the OCA recommends an adjustment to reflect the HTY level of regulatory commission expense, which results in an adjustment to reduce O&M expenses by \$462,000.[490] OCA MB at 55-56; OCA RB at 31-32.

g. Research and Development Expenses

The OCA asserts that the Company's requested \$280,000 in R&D expenses is, as pointed out by Mr. Morgan, abnormally high in comparison to prior years.[491] Specifically, the Company's R&D expenses ranged from \$59,000 in 2018 to \$253,000 in 2020.[492] Mr. Morgan testified that the Company did not provide support or reasoning for the significant increase and

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486 OCA St. 2 at 38.
487 OCA St. 2 at 38.
488 OCA St. 2 at 38.
489 *See* 66 Pa. C.S. § 510.
490 OCA St. 2, Sch. LKM-22.
491 OCA St. 2 at 37.
492 OCA St. 2 Schedule LKM-21.

when he requested support from the Company, the Company's response lacked any information or data that would explain the significant increase.[493] Further, Mr. Morgan observed that the response suggested that PECO does not expect to spend the significantly increased R&D amount.[494] As a result, Mr. Morgan adjusted the Company's R&D expense by $138,000 to reflect the Company's 3-year average spending as shown on Schedule LKM-21.[495] The OCA contends that Mr. Morgan's adjustment is reasonable and, therefore, should be accepted. OCA MB at 56-57; OCA RB at 32-33.

h. Employee Activity Costs

The Company claims that its FPFTY requested increase of approximately $71,000 in employee activity costs over the HTY spending level is attributed to reduced HTY spending due to the pandemic and the Company's expectation that FPFTY amount will be more indicative of normal spending levels.[496] OCA witness Morgan explained in his testimony that the forecasting of costs after the pandemic—particularly costs relating to employee gatherings and in-office work events—is highly speculative.[497] Mr. Morgan explains that, "[b]ecause of the uncertainty of the COVID-19 Pandemic, it is nearly impossible to forecast costs such as employee activity because it is unknown what and when the new normal will be."[498] As a result, Mr. Morgan adjusted the Company's employee activity costs by $71,000 as shown on Schedule LKM-24 to reflect the HTY spending level because it remains unknown as to what and when the new normal will be.[499] OCA MB at 57; OCA RB at 34.

The Company's witness, Mr. Stefani, disagreed with Mr. Morgan and compared the COVID-19 Pandemic to any other economic, societal and national security upheaval that has occurred in the past 45 years that have not affected the projections of future operating conditions in the Pennsylvania ratemaking process.[500] Mr. Stefani further explains that The Company's low

493 OCA St. 2 at 37.
494 *Id*.
495 *Id*.
496 OCA St. 2 at 40.
497 *Id*.
498 *Id*.
499 *Id*.
500 PECO St. 2-R at 22.

spending on employee activities during the HTY was a response to the Commonwealth's COVID-19 emergency including the stay at home orders in 2020.[501] Mr. Stefani concludes that the stay at home orders are unlikely to reoccur in 2021 and 2022.[502] OCA MB at 57-58.

As Mr. Morgan raised in surrebuttal, Mr. Stefani's justification for adjusting the Company's employee activity costs to reflect life after the pandemic fails to acknowledge that a significant portion of employee activity costs are related to gatherings of employees.[503] The OCA maintains that the Company's justification for increasing its employee activity expenses is unpersuasive in light of the in-person nature of the expenses and the anticipated long-lasting effects of the pandemic on employee activities. Accordingly, the OCA requests that the Commission deny the Company's claim and adopt the recommendation of OCA witness Morgan resulting in a downward adjustment to the Company's O&M expense of $71,000. OCA MB at 58.

i. Travel, Meals and Entertainment

The Company proposed a Travel Meals and Entertainment Expense of $343,000, based on a FPFTY ended June 30, 2022.[504] However, the OCA notes that Employee Travel Expenses have been impacted similarly to Employee Activity Expenses.[505] The uncertain nature of the COVID-19 Pandemic makes it "nearly impossible to forecast costs such as employee travel activity because it is unknown what and when the new normal will be."[506] Thus, OCA witness Morgan recommends that "[r]ather, than base the level of expense on a forecast determined from 2018 and 2019 activity," the employee activity expense should be adjusted to reflect the HTY level of expense.[507] This results is an adjustment to reduce O&M expenses by $178,000, as reflected in Schedule LKM-25.[508] OCA MB at 58-59; OCA RB at 34.

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501 *Id.*
502 *Id.*
503 OCA St. 2-SR at 22.
504 OCA St. 2, Sch. LKM-25.
505 OCA St. 2 at 40–41.
506 OCA St. 2 at 41.
507 OCA St. 2 at 41.
508 OCA St. at 41.

In his rebuttal testimony, PECO witness Stefani argued that PECO "experienced abnormally low spending on employee activities during the HTY because of the Commonwealth's response to the COVID-19 emergency . . . which are unlikely to recur in 2021 and 2022."[509] Mr. Stefani also argued that the availability of a COVID-19 vaccine and other measures will mitigate the impact of COVID-19.[510] OCA MB at 59.

The OCA maintains that predicting "what and when the new normal will be" is "nearly impossible."[511] Further, Mr. Stefani "makes no specific claim as to how those things will impact corporate travel, meals and entertainment."[512] Mr. Morgan testified that "[a]s it stands, it is nearly impossible to forecast such costs" because during the COVID-19 Pandemic "organizations have adjusted to virtual meetings, remote working and reduced public gatherings."[513] Thus, "[i]t is safe to say that for the near future, employee travel activity will be reduced." [514] Therefore, the OCA submits that the Commission should reject Mr. Stefani's position and accept the OCA's adjustment to reduce O&M expenses by $178,000, as reflected in Schedule LKM-25. OCA MB at 59; OCA RB at 35.

j. Membership Dues

The OCA did not brief this specific issue.

k. Injuries and Damages

The Company proposed to include a FPFTY budget amount for Injuries and Damages in the cost of service of $638,000.[515] However, OCA witness Morgan recommended normalizing the Injuries and Damages expense.[516] Mr. Morgan normalized the expense based on

509 PECO St. 2-R at 22.
510 OCA St. 2-SR at 23 (citing PECO 2-R at 23).
511 OCA St. 2 at 41.
512 OCA St. 2-SR at 23 (citing PECO St. 2-R at 23).
513 OCA St. 2-SR at 23.
514 OCA St. 2-SR at 23.
515 OCA St. 2 at 30, Sch. LKM-16.
516 OCA St. 2 at 30.

the most recent 3 years of actual expenses, which results in a decrease in expenses of $464,000.[517] OCA MB at 59-60.

The ratemaking technique of normalization is "used to smooth out the effects of an expense item that occurs at regular intervals, but in irregular amounts, and is a proper adjustment to make the test year expense representative of normal operations."[518] *A Guide to Utility Ratemaking* states that regularly occurring expenses should be normalized so that expenses are fairly recovered on an annual basis.[519] OCA MB at 60.

Here, Mr. Morgan testified that "the amount included in the cost of service for Injuries and Damages is significantly higher than previous years."[520] No single year is representative of the normal level of Injuries and Damages because this expense fluctuates from year to year.[521] The Injuries and Damages expenses for the years 2018, 2019, and 2020 were $301,000, $9,000, and $231,000, respectively.[522] Mr. Morgan recommends normalizing the Injuries and Damages expense "to avoid an over-recovery of costs."[523] Mr. Morgan normalized the expense based on the most recent 3 years of actual expenses, which results in a decrease in expenses of $464,000 for an amount of $174,000.[524] OCA submits that although the Company argues that the $9,000 expense was an abnormality, it provided no evidence that suggests that abnormalities such as this one will not happen again, which is why normalizing the expense is the most appropriate method of calculating the expense. OCA MB at 60; OCA RB at 37.

The OCA submits that in rebuttal, Mr. Stefani incorrectly argued that Mr. Morgan "indicated that the Company ha[d] not adequately explained the budgeted increase in injuries and damages expense for the FPFTY."[525] The OCA maintains that this was not an accurate representation of Mr. Morgan's testimony. Mr. Morgan testified that "[t]he Company has not

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517 OCA St. 2, Sch. LKM-16.
518 *TESI 2007*, 2008 Pa. PUC. LEXIS 42 at *98.
519 James H. Cawley & Norman J. Kennard, *A Guide to Utility Ratemaking*, Pa. Pub. Util. Commission 86 (2018), https://www.puc.pa.gov/General/publications_reports/pdf/Ratemaking_Guide2018.pdf.
520 OCA St. 2 at 30.
521 OCA St. 2 at 30.
522 OCA St. 2, Sch. LKM-16.
523 OCA St. 2 at 30.
524 OCA St. 2, Sch. LKM-16.
525 OCA St. 2-SR at 24 (citing PECO St. 2-R at 24).

provided any evidence to show that its claim for the FPFTY injuries and damages approximates a normalized level."[526] Thus, the OCA recommends that the Commission should reject PECO's claim and should normalize the Injuries and Damages expense "to avoid an over-recovery of costs" because the Company has not shown that its claim reflects normal amounts.[527] This would result in a reduction to the Company's O&M expense of $464,000.[528] OCA MB at 60-61.

l. Property Taxes

The Company's claimed amount for Property Taxes is $3,618,000.[529] According to the Company, "the FPFTY real estate tax is based on the FTY real estate tax including a 2.5% inflation rate escalation."[530] OCA witness Morgan recommends removing the effect of the inflation escalation on the property tax expense.[531] OCA MB at 61.

The Pennsylvania Public Utility Commission "has specifically held that inflation adjustments do not create known and measurable changes because not all expenses are affected by inflation and those that are affected by inflation experience inflation differently."[532] Further, the Commission recently disallowed the use of a blanket inflation adjustment because it does not directly relate to the actual costs expected to be incurred in each expense account in the FPFTY.[533] OCA MB at 61.

Mr. Morgan reiterates this principle and testified that "the use of adjustments based on inflation escalations . . . are not actually known and measurable."[534] Mr. Morgan testified that these adjustments "do not reflect the anticipated cost of expenses and are inconsistent with the Company's claim that the annual budgeting and planning process is

526 OCA St. 2-SR at 24.
527 *See* OCA St. 2, Sch. LKM-16.
528 OCA St. 2-SR, Sch. LKM-16.
529 OCA St. 2, Sch. LKM-28.
530 OCA St. 2 at 41.
531 OCA St. 2 at 41.
532 *Pa. Pub. Util. Comm'n v. National Fuel Gas Distribution Corporation*, Docket No. R-00942991, 1994 Pa. PUC LEXIS 134 at *138 (Pa. PUC Dec. 6, 1994) (citing *Pa. Pub. Util. Comm'n v. Pa. American Water Co.,* 71 Pa. PUC 210, 269 (1989)) (*NFGD 1994*).
533 *Wellsboro 2020* at 40.
534 OCA St. 2 at 41.

designed 'to integrate and align PECO's operational, regulatory, and financial plans."[535] Mr. Morgan reasoned that "[i]nflation adjustments are typically blanket adjustments or increases which do not directly relate to actual costs expected to be incurred by the Company in the period in which rates are to be set."[536] OCA MB at 61-62.

Mr. Morgan recommends that the "costs should be based upon evidence or documentation that supports the Company's adjustments [and does] not believe the determination of expenses for the FPFTY was envisioned to be simply applying an inflation rate to expenses."[537] Accordingly, the OCA initially recommended an adjustment to remove the effect of the inflation escalation on the property tax expense, which results in an adjustment to reduce Taxes Other Than Income by $112,000.[538] However, the OCA notes that it accepts the Company's stated position regarding the PURTA portion of the property tax expense. As a result, the OCA updated its position and recommends an adjustment to remove the effect of the inflation escalation on the real estate tax component of the property tax expense, which would reduce the Company's taxes other than income by $61,395.[539] OCA MB at 62.

m. Energy Efficiency and Conservation Program Costs

The Company is seeking to expand its existing residential energy efficiency and conservation (EE&C) programs.[540] The Company seeks approval to increase its budget by $2.492 million and adopt a residential portfolio that consists of a mix of existing, expanded, and new rebate programs, as well as two additional programs centered around low-income weatherization and emerging technologies.[541] OCA MB at 62.

The OCA submits that the Commission should deny the Company's proposed expansion of its residential energy efficiency and conversation programs. The evidence in this

535 OCA St. 2 at 41–42 (quoting PECO St. 2 at 10).
536 OCA St. 2 at 42.
537 OCA St. 2 at 42.
538 OCA St. 2, Sch. LKM-28.
539 *See* OCA R.B., App. A, Table II.
540 PECO St. 9 at 6.
541 *See* PECO St. 9 at 6-9.

proceeding demonstrates that over the past several years the Company has underspent its existing budget by a significant margin. Moreover, the TRC analysis provided by the Company demonstrates that the Company's proposed portfolio is marginally cost-effective at best. Accordingly, the Commission should deny the Company's request. OCA MB at 62.

Rather, the Commission should adopt the recommendation of OCA witness, Geoffrey Crandall, which recommends that the Company maintain its existing EE&C budget and adopt a proposed portfolio that is consistent with Mr. Crandall's recommended portfolio. Mr. Crandall's recommended portfolio has been shown to be more cost-effective than PECO's proposal. Adoption of the OCA's position would reduce the Company's proposed expense by approximately $2.492 million.[542] OCA MB at 62-63; OCA RB at 39.

n. Rate Case Expense Normalization

The Company's rate case expense claim of $1.5 million is based on the inclusion of the fees for legal services and consultants to prepare and adjudicate the present case.[543] The amount was normalized by the Company over a three-year period to derive an annual expense of $520,000.[544] The Company cites its "need to file another rate case in three years" as the reason for a three-year normalization period.[545] However, Mr. Morgan recommended "an adjustment to normalize the rate case expense over a 5-year period . . . based on the Company's history of the frequency of rate case filings" in the past.[546] Accordingly, Mr. Morgan recommended that the Commission reduce the rate case expense claim by $208,000.[547] OCA MB at 63.

The Commission has consistently held that that rate case expenses are normal operating expenses, and normalization should, therefore, be based on the historical frequency of

542 *See* OCA. St. 2 at 41; *see also* OCA St. 2-SR, Sch. LKM-26, Line 3.
543 OCA St. 2 at 30.
544 OCA St. 2 at 30–31.
545 PECO St. 3-R at 22.
546 OCA St. 2 at 31.
547 OCA St. 2 at 31.

the utility's rate filings.[548] In recent cases, the Commission reiterated that the normalization period is determined, "by examining the utility's actual historical rate filings, not upon the utility's intentions."[549] Basing the normalization period on historical filing frequency is reasonable because it represents known and measurable data. Speculation about the timing of future filings cannot be relied on to determine the proper normalization period.[550] OCA MB at 63-64; OCA RB at 40.

The Company's rate case expense normalization period must accurately reflect the Company's filing history. The Company's position to normalize its rate case expense over three years, does not accurately reflect the Company's filing history, as its last rate case filing was approximately 10 years ago.[551] Thus, the OCA recommends that the rate case expense be normalized over a five-year period. OCA MB at 64.

Regarding the rate case amount requested by the Company, "the estimated costs are comparable to the costs incurred recently by the Company's electric division for its rate case [that] was adjudicated under the normal approach that included travel for hearings, document reproduction, etc."[552] However, because this proceeding is mostly being done virtually, "it is possible that there may be some cost savings."[553] Mr. Morgan recommended that "[r]ather than estimate those savings, the annual cost reduction brought about by the 5-year normalization will also serve to reflect the potential savings derived from the decreased travel and document reproduction."[554] Accordingly, the OCA recommends that the Commission reduce the rate case expenses by $208,000.[555] OCA MB at 64.

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548 *Popowsky v. Pa. Pub. Util. Comm'n*, 674 A.2d 1149, 1154 (Pa. Commw. Ct. 1996), *Pa. Pub. Util. Comm'n v. Columbia Water Co.*, Docket No. R-2008-2045157, 2009 Pa. PUC LEXIS 1423 (Pa. PUC May 28, 2009) (CWC 2008); *City of Lancaster (Sewer Fund) v. Pa. Pub. Util. Comm'n*, 793 A.2d 979 (Pa. Commw. Ct. 2002) (*Lancaster 2002*); *Pa. Pub. Util. Comm'n v. West Penn Power Co.*, Docket No. 901609, 1990 Pa. PUC LEXIS 142 at *108-110 (Pa. PUC Dec. 13, 1990).

549 *Pa. Pub. Util. Comm'n v. City of Lancaster*, Docket No. R-2010-2179103, 2011 Pa. PUC LEXIS 1685 (Pa. PUC Jul. 14, 2011) (*Lancaster 2011); Pa. Pub. Util. Comm'n v. Metropolitan Edison Co.*, Docket No. R-00061366, 2007 Pa. PUC LEXIS 5 (Pa. PUC Jan. 11, 2007); *Pa. Pub. Util. Comm'n v. City of Dubois – Bureau of Water*, Docket No. R-2016-2554150, Opinion and Order at 65 (Pa. PUC May 18, 2017) (*City of Dubois*).

550 *See e.g. Lancaster 2011*.

551 OCA St. 2 at 31.

552 OCA St. 2 at 31.

553 OCA St. 2 at 31.

554 OCA St. 2 at 31, Sch. LKM-17.

555 OCA St. 2, Sch. LKM-17.

o. Regulatory Initiatives

The OCA indicates that, upon review of the Company's adjustments at the behest of OCA witness Morgan, it has no further adjustment to the $47,000 claimed by the Company for regulatory initiatives expense. OCA RB at 41-42.

p. Manufactured Gas Plant Remediation Expense

The Company proposed an adjustment to the Manufactured Gas Plant (MGP) Remediation Expense at an annual cost of $804,000.[556] The amount was based on a nine-year recovery of an estimated total of $7.2 million to remediate former MGP sites.[557] The OCA recommends that the Commission require the Company to recover the remaining remediation cost over a 14-year period instead, which is consistent with the settlement in Docket No. R-2010-2161592, resulting in an annual recovery of $517,000.[558] The OCA further recommends that the Company be required to impute carrying costs on the over-collected MGP remediation cost that is held by the Company.[559] OCA MB at 68.

The Company claims that it has eight remaining sites with an overall estimated liability of $21.5 million to remediate, $7.237 million of which it has not recovered.[560] According to the company, "[t]he nine-year amortization period is based on recovery of the unrecovered MGP remediation costs over three future rate cases as PECO expects to file a base rate case every three years."[561] In Docket Nos. R-2008-2028394 and R-2010-2161592, the Company reached settlements with the intervening parties, which included a recovery mechanism for MGP remediation costs that designated annual recovery of MGP remediation.[562] The Company determined that, based on this annual recovery, "out of the $21.5 million to remediate the remaining sites, it had pre-collected $14.3 million, resulting in an unrecovered

[556] OCA St. 2 at 27.
[557] OCA St. 2 at 27–28.
[558] OCA St. 2 at 29–30.
[559] OCA St. 2 at 30.
[560] OCA St. 2 at 28.
[561] OCA St. 2 at 28 (quoting PECO Response to I&E-RE-45-D(g)).
[562] OCA St. 2 at 28.

amount of $7.2 million."[563] From a ratemaking perspective, "this $14.3 million represents an over-collection of ratepayer funds that is being held by the Company, which can be used for general corporate purposes until it is needed for MGP remediation."[564] Mr. Morgan has not observed any carrying charge being credited to ratepayers from the analyses that the Company provided with respect to the MGP remediation.[565] OCA MB at 68.

OCA witness Lafayette K. Morgan recommends that the Company should not be allowed to recover the $7.2 million over a nine-year period as it proposes.[566] Mr. Morgan testified that "[t]he settlement language in Docket No. R-2010-2161592, was specific as to the recovery of the MGP remediation costs in this base rate proceeding."[567] The settlement stated the following:

> The Joint Petitioners further agree that, in PECO's next general gas base rate case, the Company's MGP remediation expense allowance will be reset based on: (1) **a normalized annual level of MGP remediation costs to be incurred over the remainder of its MGP remediation program**, and (2) the difference between (a) $5.982 million per year times the number of years (including partial years as a fraction) that the Settlement Rates are in effect, and (b) the actual, prudently-incurred MGP remediation costs, net of insurance recoveries, experienced during that same period.[568]

Based on the Company's response to OCA-XIII-18, the remediation is expected to extend through 2034, 14 years from this year.[569] Thus, Mr. Morgan recommends that "the $7.2 million be recovered through 2034, consistent with the settlement, instead of the 9 years proposed by the Company," which will result in an adjustment that reduces O&M expenses by $287,000.[570] Mr. Morgan also recommended that the Company be required to impute carrying costs on the over-collected MGP remediation cost that is held by the Company.[571] Mr. Morgan testified that the

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563 OCA St. 2 at 28.
564 OCA St. 2 at 28.
565 OCA St. 2 at 28–29.
566 OCA St. 2 at 29.
567 OCA St. 2 at 29.
568 *Pa. Pub. Util. Comm'n v. PECO Energy Co. – Gas Division*, Docket No. R-2010-2161592, Joint Petition for Settlement of Rate Investigation at 4-5 (Aug. 31, 2010) (*PECO Gas 2010*).
569 OCA St. 2 at 29.
570 OCA St. 2 at 29–30, Sch. LKM-15.
571 OCA St. 2 at 30.

$14.5 million over-collection represents ratepayer funds that are "being held by the Company [and] can be used for general corporate purposes until it is needed for MGP remediation."[572] Mr. Morgan also testified that "[r]atepayers should not be in the position of providing cost-free capital to the Company."[573] OCA MB at 69.

The Company agreed to impute carrying costs on the over-collected MGP remediation cost that is held by the Company.[574] Thus, the OCA recommends that the Commission require the Company to recover the remaining remediation cost over a 14-year period consistent with the 2010 Settlement in Docket No. R-2010-2161592, which would result in an annual recovery of $517,000 and a downward adjustment of $287,000 to the Company's O&M expenses.[575] The Commission should also require the Company to impute carrying costs on the over-collected MGP remediation cost that is held by the Company until it is needed for MGP remediation. OCA MB at 70.

q. Depreciation Expense

Consistent with the plant in service adjustment recommended by OCA witness Lafayette K. Morgan, the OCA recommends a derivative adjustment that lowers the depreciation expense by $7,827,000 if Mr. Morgan's Plant in Service recommendation is adopted by the Commission.[576] OCA MB at 70.

4. OSBA's Position

The OSBA did not take a position on any expense issues.

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572 OCA St. 2 at 30.
573 OCA St. 2 at 30.
574 PECO St. 3-R at 26.
575 OCA St. 2 at 29–30, Sch. LKM-15.
576 *See* OCA St. 2, Sch. LKM-27.

5. CAUSE-PA's Position

CAUSE-PA did not take a position on any expense issues.

6. PAIEUG's Position

PAIEUG did not take a position on any expense issues.

7. ALJ's Recommendation on Expenses

a. Payroll and Payroll Related Expenses

The OCA proposed an adjustment of $2,447,000 to PECO's FPFTY payroll expense based on OCA witness Morgan's adjustment to PECO's employee headcount, as well as on the elimination of past costs for a one-time bonus paid in exchange for ratification of the union contract on or before December 31, 2014. I agree with the OCA's adjustment to PECO's employee headcount for the FPFTY, as PECO's headcount for the FPFTY was not adequately supported. Considering that the Company fell substantially short of its anticipated headcount for 2020, its projected headcount for the FPFTY is speculative at best. Moreover, adopting OCA's adjustment will lead to a reasonable and just rate, as ratepayers will not be paying for the costs of employees who have not been hired.

Additionally, and as identified by Mr. Morgan, adjusting the employee headcount requires a concomitant adjustment to the Company's Projected Employee Benefits expense.[577] Accordingly, I recommend that the Commission adjust the employee benefits expense by $315,000 to reflect 604 employees instead of 639 employees.

As for the elimination of past costs for the one-time bonus, I again agree with the OCA's assessment that these payments were made in 2015 and were not connected to any future requirement of the employees. The Company's attempts to recover these costs from several

[577] OCA St. 2, Sch. LKM-12.

years ago would violate the rule against retroactive ratemaking. Accordingly, I recommend that these costs be excluded from payroll expense.

b. Contracting and Materials Expense

I&E proposed a reduction of $10,015,000 to the Company's $42,955,000 claimed contracting and materials expense for the FPFTY based on an average of PECO's last three years of contracting and materials expenses. As pointed out by I&E, the Company's actual contracting and materials expense was underspent in 2017, 2018 and 2019. Although the Company asserts that its reduced contracting and materials expenses in 2020 was the result of work stoppages due to the COVID-19 pandemic, I agree with I&E that it would be speculative at best to assume that the pandemic will not have any impact on the Company's projects in the FTY and the FPFTY and that the Company will be able to spend its entire budgeted amount for those periods. For this reason, I find I&E's three-year average to be a more prudent approach to calculating the Company's contracting and materials expense.

Accordingly, I recommend that the Commission adopt I&E's proposed reduction to PECO's claimed contracting and materials expense for the FPFTY.

c. Outside Services (Including Exelon Business Service Company Charges)

I&E recommended an allowance of $13,437,856 (or a reduction of $3,134,1444) to the Company's claim for outside services net of the cost to achieve adjustment of $370,000. I&E argued that the Company's increase of 26.55% in the FTY over the HTY actual expense and additional 4.57% increase for the FPFTY are unsupported. I agree with I&E that the Company's claimed increase in outside services expenses is overstated and unsupported. I&E witness Patel's testimony that the Company had been experiencing a declining trend in both the EBSC costs and the contracting service costs for the three years prior to the FTY was particularly persuasive:

First, MR. Stefani attempts to justify the unsupported significant increase of 26.55% int the FTY of the HTY (2019-20) actual expense and an additional 4.57% increase in the FPFTY claim for outside services expense by comparing the FPFTY total EBSC cost with the historic three-year average of EBSC cost, a component of the outside services claim. In this context for the sake of clarity, a table showing the breakdown of outside services (Account 923) and each expense item's trend is reproduced below in summarized form, based on data provided by the company in response to I&E-RE-33-D (I&E Statement No. 1, pp. 20-21 and I&E Exhibit No. 1, Schedule 4, pp. 1-7):

	2017-18	2018-19	2019-20	FTY	FPFTY
Various (EBSC)	$14,332,000	$13,815,000	$11,555,000	$14,622,000	$15,290,000
Contracting Professional	$534,000	$784,000	$715,000	$905,000	$946,000
Contracting Services	$781,000	$552,000	$548,000	$694,000	$726,000
Total	$15,647,000	$15,151,000	$12,818,000	$16,221,000	$16,962,000
% Change		-3.17%	-15.40%	26.55%	4.57%

The above table shows that PECO has experienced a declining trend in the EBSC cost and contracting services expense. The FPFTY EBSC claim of $15,290,000 is higher by 15.53% over the historic three-year average of $13,234,000. Similarly, the FPFTY contracting service claim of $726,000 is higher by 15.79% over the historic three-year average of $627,000. Additionally, PECO's FPFTY outside services (Account 923) claim of $16,572,000 ($16,942,000 - $370,000 (cost to achieve)) is unchanged and is a part of the total O&M expense claim of $466,639,000 shown in the computation of the revised revenue requirement (PECO Exhibit MJT-1 Revised, Schedule A-1, p. 1 and Schedule D-4, p. 56). Therefore, [PECO witness] Stefani's assertion of reasonableness is not convincing when the significant increase in the FTY and FPFTY outside service claims are not properly justified and supported.[578]

I agree with I&E's argument that the use of inflation factors to determine a proforma expense allowance is acceptable, as long as the inflation factors used are specified and

578 I&E Statement No. 1-SR, pp. 15-16.

the determined amounts are supported by calculations.[579] Since that did not happen here, I recommend that the Commission adopt I&E's proposed allowance of $13,437,856 for outside services.

d. Other Post-Employment Benefits Expense

The Company is claiming OPEB expense of $1,050,000 in the FPFTY which it acknowledges is a significant increase over prior years' OPEB expenses because prior to 2015 the Company provided eligible retirees a Company-sponsored medical plan with a traditional cost-sharing arrangement. I&E recommended an allowance of $270,000 because the Company's projected increases in the FTY and FPFTY were based on assumptions which are not supported. For its part, the OCA recommended that Commission should adopt its proposed adjustment to normalize the Company's OPEB expense over the three-year period (2020-2022), which would result in a reduction of $486,000 from the Company's OPEB claim.

I agree with the OCA's approach in this instance that in order to properly capture the Company's predicted rise in OPEB expense due to the expiration of the prior service credit in 2021, the actual and projected OPEB expenses for the years 2020-2022 should be averaged, which will reflect a more accurate and normalized level of OPEB expenses. As noted by the OCA, OPEB expenses can fluctuate from year to year. Therefore, the normalization adjustment recommended by the OCA is reasonable.

Accordingly, I recommend that the Commission adopt the OCA's proposed $486,000 reduction to the Company's OPEB claim.

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579 *Pa. Pub. Util. Comm'n v. Citizens' Elec. Co. of Lewisburg PA*, Docket No. R-2019-3008212 (Order entered April 27, 2020). ("We agree with the ALJs that the Company did not meet its burden in demonstrating that its proposed blanket 3% inflation adjustment to all expenses would meet the 'known and measurable' standard for increasing each FTY expense claim in the FPFTY.")

e. Costs to Achieve Exelon/PHI Merger

The Company is seeking to recover $1,111,000 in costs related to the 2016 merger of PECO's parent, Exelon Corporation with Pepco Holdings, Inc, asserting that the merger resulted in significant cost savings to PECO. I agree with both I&E's and OCA's arguments and recommendations that these claimed expenses should be rejected in full because the Company's claim for recovery of historic merger costs would result in retroactive ratemaking in the absence of the Commission's prior permission to defer the merger related costs for ratemaking purposes. Moreover, these merger costs were incurred between 2016 and 2018, prior to the HTY, and the offsetting merger related savings were also realized in prior years. Lastly, the savings that PECO has generated from the merger were retained by the Company, and PECO's customers have not experienced any reduction in rates as a result of the merger.

Accordingly, I recommend that the Commission adopt I&E's and the OCA's proposal to reject the Company's proposal to recover $1,111,000 in costs related to the 2016 merger of Exelon Corporation with Pepco Holdings, Inc.

f. Regulatory Commission Expenses/General Assessments

The OCA challenged the Company's claim for general assessments, or regulatory commission expenses, which include assessments for the Commission, the OCA, the OSBA, and the Commission's Damage Prevention Committee. The OCA proposed an adjustment to reflect the HTY level of general assessments resulting in a $462,000 reduction in the Company's claim arguing that adjustments based on inflation factors are inappropriate. However, I am persuaded by the Company's position that the Company's actual FTY increase of $288,000 (16%) over the HTY level of expense substantiates the Company's FTY claim of $2,197,000. Moreover, I find the Company's argument, that to use the actual 16% increase in the FPFTY would result in an even greater claimed expense, to be persuasive as well.

While I agree that the use of inflation factors that are not known or measurable is inappropriate, in this instance, using the actual percentage increase in general assessments for the

FTY to forecast PECO's regulatory commission expense for the FPFTY would exceed the Company's actual claim. Under these circumstances, I am inclined to agree with the Company's calculation, and recommend that the Commission accept the Company's claim for Regulatory Commission Expenses/General Assessments.

g. Research and Development Expenses

The OCA noted that PECO projected the FPFTY R&D Expenses to be $280,000. The OCA also noted that when reviewed in conjunction with previous years, the FPFTY amount appeared to be abnormally high. The OCA argued that the Company could not provide a specific reason to attribute the cause of the increase. Based on this, the OCA concluded that the Company essentially admitted that it does not expect to incur R&D expenses at the level it has projected. Accordingly, the OCA concluded that PECO's budgeted R&D expense does not reflect the Company's anticipated expenses and are inconsistent with the Company's claim that the annual budgeting and planning process is designed to integrate and align PECO's operational, regulatory, and financial plans.

Upon review of the record, I agree with the OCA that the Company did not provide support or reasoning for the proposed increase. It is equally important to note the Company's argument that to use 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. While the Company's diversion of funds from R&D for high priority needs such as emergent gas leak events is laudable, the fact that the Company regularly draws on these funds for other uses leads to a reasonable conclusion that the entire claimed amount is not justified.

Accordingly, I recommend that the Commission adopt the OCA's proposal to reduce the Company's claim by $138,000, based upon the Company's three-year average spending.

h. Employee Activity Costs

PECO has proposed to recover the costs of certain employee activities totaling $139,402 that it claims provides important benefits in terms of employee morale and productivity. I&E recommended disallowance of the Company's sponsored employee picnic and celebration expenses of $80,933 from the Company's total claim, arguing that these expenses are not necessary for the provision of safe and reliable gas service to ratepayers. The OCA recommended a downward adjustment of $71,000 to the Company's claim, based on the in-person nature of the expenses and the anticipated long-lasting effects of the pandemic on employee activities.

I agree with the OCA that, in light of the COVID-19 pandemic, the Company's $71,000 FPFTY increase over the reduced HTY spending level (also due to the pandemic) is highly speculative. Although the Company understandably noted that PECO's abnormally low spending on employee activities during the HTY because of the Commonwealth's response to the COVID-19 emergency, including stay-at-home order during the second quarter of 2020, we do not know for certain that that the impacts of the pandemic are behind us. Although several vaccines are now available, it remains unknown how long it will be before we return to life as it existed before the onset of the pandemic. As such, the Company's claimed increase in Employee activity costs is speculative at best.

Accordingly, I recommend that the Commission adopt the OCA's proposal to reduce the Company's claim for Employee Activity Costs by $71,000.

i. Travel, Meals and Entertainment

The Company is claiming Travel, Meals and Entertainment Expense of $1,032,000 in the FPFTY. I&E recommends a reduction of $169,847 based on applying the CPI inflation factor of 2.03% to the FTY claim to determine a FPFTY allowance, and the rejection of PECO's significant increase of 22.13% arguing that the FPFTY claim is unsupported, speculative, and inconsistent with the Company's assertion for an increased claim due to general inflation. The OCA recommends a reduction of $178,000, arguing that the uncertain nature of the pandemic makes it nearly impossible to forecast costs such as employee travel activity because it is unknown what and when the new normal will be.

For the reasons stated in the previous section regarding Employee Activity Costs, I am inclined to agree with the OCA. In this instance, I agree with the OCA that rather than base the level of expense on a forecast determined from 2018 and 2019 activity, this expense is more appropriately adjusted to reflect the HTY level of expense. Accordingly, I recommend that the Commission adopt the OCA's proposal to reduce the Company's claim for Travel, Meals and Entertainment expense by $178,000.

j. Membership Dues

The Company claimed membership dues expense of $646,899 in the FTY and $655,897 in the FPFTY. PECO argued that its budgeted amounts for membership dues in the FTY and FPFTY are reasonable, because the company's actual membership dues expense has fluctuated in the prior three years. PECO maintains that the HTY was an aberration, not indicative of future levels of expense, and that the Company's inflationary increases are less than the inflationary increases proposed by I&E.

I agree with I&E that the increases proposed by the Company are speculative and unreliable because they are not consistent with acceptable inflation rates. I&E instead applied a CPI factor of 2.75% to the HTY and an additional 2.03% to the FTY allowance to determine the recommended FPFTY allowance. As I find I&E's determination to be reliable, I recommend that the Commission adopt I&E's proposal to reduce the Company's claim for Membership Dues by $67,762.

k. Injuries and Damages

The Company claimed Injuries and Damages expense of $638,000 for the FPFTY. The Company explained that this expense was derived from a third-party actuarial report the Company obtained. The OCA asserted that the Company's claimed expense for Injuries and Damages is significantly higher than in previous years, that the nature of Injuries and Damages is one that fluctuates from year to year, and that no single year is representative of the normal level of expense. Because of this, the OCA concluded that it is appropriate to normalize this expense to avoid an over-recovery of costs, and recommended a $464,000 decrease in the claimed expense.

As support for its position, PECO argued that the OCA's three-year average proposal is unreasonable because it would reflect what it characterized as an aberration, a negative $9,000 expense which resulted from an actuarial update. The Company asserted that this negative amount is the type of aberration that normalization attempts to avoid being reflected in rates, because it would unreasonably skew the Company's three-year average downwards. As such, the Company believes that it would be unreasonable to impose a three-year historical average in place of an independent third-party recommendation when one of the years considered in that average contains an abnormally low negative expense amount.

While it appears that the one-year negative $9,000 expense is an aberration, I agree with the OCA that normalization is the appropriate methodology for calculating this expense for the FPFTY. While this one year will undoubtedly have an impact on the average, I do agree with the OCA that this is the best approach to smooth out the effects of this expense that occurs at regular intervals but in irregular amounts. Accordingly, I recommend that the Commission adopt the OCA's proposal to reduce the Company's claim for Injuries and Damages by $464,000.

l. Property Taxes

The Company explained that its claim for property tax expense was based on the Company's most recent actual property tax bills from 136 municipalities with an adjustment to apply a 2.5% inflation factor. The Company asserted that it is reasonable to assume that its property tax expense will increase consistent with the inflation adjustment utilized by the Company. The OCA disagreed with the Company's approach, challenging the Company's use of inflation escalations because they are not actually known and measurable. The OCA further argued that inflation adjustments are typically blanket adjustments or increases that do not directly relate to the actual costs expected to be incurred by the Company in the period in which rates are to be set. The OCA maintains that these costs should instead be based upon evidence or documentation that supports the Company's adjustments.

I agree with the Company's use of the 2.5% inflation factor to calculate its Property Tax expense. I agree that this is not a blanket, across-the-board, inflation adjustment. Rather, this is an inflation adjustment applied to a specific expense. Moreover, I agree that it is reasonable to assume that the Company's property taxes will increase on par with a reasonable rate of inflation. Accordingly, I recommend that the Commission accept the Company's as-claimed Property Tax expense.

m. Energy Efficiency and Conservation Program Costs

PECO requested $4.5 million in annual funding for its gas EE&C programs. The Company asserts that its funding request would increase the annual budget of the gas EE&C program and allow it to expand program offerings to residential customers and income eligible customers, pursue innovative pilot projects, and support new marketing and outreach to increase customer participation in the program. I&E recommended reducing the Company's claimed EE&C costs by $1,772,500 based on the limited historic success rate of PECO's current rebate programs. The OCA proposed reducing the Company's claim by $2.492 million. The OCA asserted that the Company should maintain its existing EE&C budget since the Company has underspent its existing budget by a significant margin over the past several years.

I agree with I&E that the Company should not be permitted an increase for its annual funding for its gas EE&C programs. The record reflects that past customer participation levels have not met projections and that program expenditures have been significantly less than the budgeted amounts. Because PECO has historically underspent its EE&C budget, I also agree with I&E's position that the Company should accommodate any and all new program costs within its existing budget. Moreover, I agree with I&E that the Company's projected increase in customer participation in the FPFTY is speculative, unreasonable, and not supported by historic participation levels.

Accordingly, I recommend that the Commission accept I&E's proposal to reduce the Company's claimed gas EE&C expenses by $1,772,500.

n. Rate Case Expense Normalization

PECO has claimed an allowance for rate case expense in the aggregate amount of $1.6 million and is proposing to amortize this amount over a three-year period, resulting in a normalized claim of $520,000 per year. The Company argued that the three-year amortization period is appropriate because it anticipates that it will need to file another rate case in three years. However, both I&E and OCA have recommended a five-year normalization period for rate case expense instead of the three-year normalization period utilized by PECO. I&E and the OCA based their five-year recommendation on PECO's historic rate case filing frequency (as opposed to their stated intention to file another rate case in three years).

I agree with I&E and OCA that the Company's rate case expense should be normalized over a five-year period. In the recent *Columbia Gas* case, the Commission indicated that "the normalization period should align with the historic data rather than the Company's assertion" as to when it is likely to file their next base rate case.[580] Since 2010, PECO gas has filed two base rate cases, with the first case being filed in 2010 and the second case being filed in 2020. Based on the PECO's filing history, the appropriate length of time for normalization for the Company's rate case expense is five years. Accordingly, I recommend that the Commission accept I&E's and the OCA's position that the Company's rate case expense be normalized over a period of five years.

[580] *Pa. Pub. Util. Comm'n v. Columbia Gas*, R-2020-3018835 at 78-79 (Opinion entered February 19, 2021).

o. Regulatory Initiatives

PECO has claimed $47,000 to amortize over a period of three years the O&M and depreciation expenses that the Company incurred to establish a Gas Procurement Charge ("GPC") and Merchant Function Charge ("MFC") pursuant to the Commission approved settlement of PECO's natural gas unbundling rate proceeding at Docket No. P-2012-2328614. I&E disagrees with the Company's proposed three-year amortization period and instead requests a five-year amortization period, on the basis that a five-year amortization period is consistent with I&E's recommended normalization period of five years for rate case expense to reduce the impact of historic costs in rates. For the reasons stated regarding Rate Case Expense normalization, I agree with I&E and recommend that the Company's Regulation Initiatives expense be normalized over a period of five years.

p. Manufactured Gas Plant Remediation Expense

PECO proposed an adjustment to the MGP Remediation Expense at an annual cost of $804,000, based on a nine-year recovery of an estimated total of $7.2 million. Regarding the $14.3 million of MGP remediation expenses that the OCA alleged were over-collected, PECO maintains that these MGP funds were not over-collected. Rather, this amount represents funds collected from PECO customers that PECO intends to spend on MGP projects. However, PECO indicated that it agreed to pay interest on the monthly balance of MGP funds that are not yet spent on remediation activities at the residential mortgage lending rate specified by the Secretary of the Pennsylvania Department of Banking and Securities after July 1, 2021, when new rates will take effect. The Company indicated that this interest will accrue and be applied to reduce revenue requirements in PECO's next gas base rate proceeding.

The OCA argues that the Company should recover the remaining remediation costs over a fourteen-year period instead, which it asserts is consistent with the settlement at Docket No. R-2010-2161592,[581] which would result in an annual recovery of $517,000. The OCA further argues that the Company should be required to impute carrying costs on the over-

[581] *Pa. Pub. Util. Comm'n v. PECO*, Docket No. R-2010-2161592 at 7 (Order entered December 29, 2010).

collected MGP remediation cost that is held by the Company until it is needed for MGP remediation.

I agree with the OCA that the MGP Remediation Expense should be recovered over a fourteen-year period as opposed to the Company's requested nine-year period. As previously noted, the Settlement at Docket No. R-2010-2161592 included the following language:

> The Joint Petitioners further agree that, in PECO's next general gas base rate case, the Company's MGP remediation expense allowance will be reset based on: (1) **a normalized annual level of MGP remediation costs to be incurred over the remainder of its MGP remediation program**, and (2) the difference between (a) $5.982 million per year times the number of years (including partial years as a fraction) that the Settlement Rates are in effect, and (b) the actual, prudently-incurred MGP remediation costs, net of insurance recoveries, experienced during that same period.[582]

The Company, in a response to an OCA interrogatory, indicated that the remediation is expected to extend through 2034, a period of fourteen years since the Company filed its base rate case. Based upon the terms of the 2010 Settlement and PECO's response to OCA's interrogatory that the remediation is expected to last fourteen more years, it is reasonable to extend its recovery of the remaining remediation costs over a fourteen-year period. However, I agree with the Company that its approach of paying interest on the monthly balance of MGP funds that are not yet spent on remediation activities at the residential mortgage lending rate specified by the Secretary of the Pennsylvania Department of Banking and Securities after July 1, 2021, when new rates will take effect, to be reasonable.

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582 *Pa. Pub. Util. Comm'n v. PECO Energy Co. – Gas Division*, Docket No. R-2010-2161592, Joint Petition for Settlement of Rate Investigation at 4-5 (Aug. 31, 2010).

q. Depreciation Expense

This was already discussed under Section V.B.7 of this Recommended Decision. Based on my determinations under that section, the total allowable depreciation expense is $804,000.

E. Taxes

1. PECO's Position

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

PECO's Federal and State income taxes change based on changes in revenue and expenses (including deductible interest expense) and return. In addition, income taxes will also change based on changes in tax depreciable property due to changes in the depreciation that is deducted in the tax calculation. For this reason, the OCA's proposal to eliminate PECO's rate base claim for FPFTY plant additions would have the concomitant effect of increasing income taxes. PECO notes that OCA witness Morgan conceded this point in his surrebuttal testimony[583] and reflected the concomitant adjustments in OCA Schedule LKM-31.

2. I&E's Position

I&E recommended an allowance of $3,699,145 for payroll tax expense, or a reduction of $76,855 ($3,776,000 - $3,699,145) to the Company's claim.[584] I&E's recommendation for a reduction of payroll tax expense was based on I&E's recommended reduction to payroll expense.[585] I&E MB at 50; I&E RB at 30.

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583 OCA St. 2-SR, pp. 10-11

584 I&E St. No. 1, p. 18.

585 *Id.*

PECO disagreed with the I&E payroll tax expense adjustment based on PECO's denial of I&E's payroll expense adjustment.[586] I&E MB at 51; I&E RB at 30.

In consideration of the record evidence presented, I&E continues to recommend an allowance of $3,699,145 for payroll tax expense, and accordingly, a reduction of $76,855 to PECO's claim of $3,776,000.[587] I&E MB at 51.

3. OCA's Position

Property Taxes

According to the Company, "the FPFTY real estate tax is based on the FTY real estate tax including a 2.5% inflation rate escalation."[588] However, the OCA recommends an adjustment to reduce Taxes Other Than Income by $61,395.[589] OCA witness Morgan disagreed with the Company's use of adjustments that are based on inflation escalations.[590] Mr. Morgan reasons that these adjustments "are not actually known and measurable" because "[t]hey do not reflect the anticipated cost of expenses and are inconsistent with the Company's claim that the annual budgeting and planning process is designed 'to integrate and align PECO's operational, regulatory, and financial plans."[591] As previously discussed, "[i]nflation adjustments are typically blanket adjustments or increases which do not directly relate to actual costs expected to be incurred by the Company in the period in which rates are to be set."[592] OCA MB at 71.

Mr. Morgan recommends basing costs on "evidence or documentation that supports the Company's adjustments."[593] Further, Mr. Morgan does not believe that "the determination of expenses for the FPFTY was envisioned to be simply applying an inflation rate

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586 PECO St. No. 2-R, pp. 9-11.
587 *See* I&E St. No. 1-SR, pp. 13-14; I&E St. No. 1, p 18.
588 OCA St. 2 at 41.
589 OCA initially recommended an adjustment of $112,000. OCA St. 2 at 42, Sch, LKM-28.
590 OCA St. 2 at 41.
591 *Id*. at 41–42 (quoting PECO St. 2 at 10).
592 *Id*. at 42. *See also Wellsboro 2020* at 40.
593 OCA St. 2 at 42.

to expenses."[594] Thus, the OCA recommends "an adjustment to remove the effect of the inflation escalation on the property tax expense." Although the OCA initially recommended a $112,000 adjustment, the OCA's removal of the PURTA expense from the property tax expense adjustment produces an updated reduction of Taxes Other Than Income of $61,395. OCA MB at 71; OCA RB at 44.

Payroll Taxes.

The OCA recommends a reduction to payroll taxes of $187,000. As noted by the OCA previously, OCA witness Morgan recommended an adjustment to Payroll Expense.[595] Thus, because of the reduction to Payroll Expense, "there is a corresponding effect on payroll taxes since payroll taxes are calculated as a percentage of payroll."[596] Consequently, Mr. Morgan "applied the FICA and Medicare tax rate to the decrease in payroll to derive [his] adjustment which reduces payroll taxes by $187,000."[597] OCA MB at 71-72.

Federal Income Tax.

In his Direct Testimony, OCA witness Morgan recommended removing the Company's plant additions projected for FPFTY. In his rebuttal testimony, however, PECO witness Trzaska stated that Mr. Morgan failed to propose an adjustment to the tax repairs deduction that would be associated with the disallowance of incremental FPFTY plant additions.[598] Mr. Morgan acknowledged that his "adjustment to plant in service reduced the plant in service balance to reflect the FTY level of plant."[599] As such, he stated that it was an oversight on his part to not "have recalculated income taxes too by using the repairs deduction that corresponds to the FTY in the calculation of income taxes instead of leaving the effect of the FPFTY repairs deduction in the income tax expense."[600] Mr. Morgan "corrected the income tax

594 *Id.*
595 OCA St. 2 at 42.
596 *Id.*
597 *Id.*, Sch. LKM-29.
598 PECO St. 3-R at 7.
599 OCA St. 2-SR at 11.
600 *Id.*

calculation to reflect the FTY repairs deduction [and] reflected the FTY accelerated state and federal tax depreciation in [his] corrected income tax calculation."[601] OCA MB at 72.

4. OSBA's Position

The OSBA did not brief any specific tax issues.

5. CAUSE-PA's Position

CAUSE-PA did not brief any specific tax issues.

6. PAIEUG's Position

PAIEUG did not brief any specific tax issues.

7. ALJ's Recommendation on Taxes.

a. Payroll Tax Expense

In Section V.D.7.a of this Recommended Decision, I addressed the parties' arguments regarding payroll expense. As part of my discussion, I accepted the OCA's $2,447,000 adjustment to PECO's FPFTY Payroll Expense. I agree with the OCA that, due to the aforementioned reduction to Payroll Expense, there is a corresponding effect on payroll taxes since payroll taxes are calculated as a percentage of payroll. Accordingly, I agree with the OCA that the Company's claimed payroll taxes should be reduced by $187,000.

b. Property Tax Expense

In Section V.D.7.l of this Recommended Decision, I addressed the parties' arguments regarding property taxes. As part of my discussion, I accepted the Company's as

601 OCA St. 2-SR, Sch. LKM-31.

claimed property tax expense. Accordingly, I will not recommend any changes to the Company's claimed property tax expense.

F. Rate of Return

1. PECO's Position

a. Introduction

A reasonable and fair rate of return for PECO has been submitted in this case through the testimony and exhibits of PECO witness Moul. 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%. The Company's overall rate of return should be set at 7.64%.[602] PECO MB at 53-54; PECO RB at 37.

PECO notes that the methodological positions of OSBA, OCA, and I&E on the rate of return for PECO vary in many respects. However, while PECO asserts that there are significant flaws in the rate of return analyses of I&E, the rate of return positions advanced by OSBA and OCA are extreme and troubling. OCA proposes a 6.30% rate of return that is wholly inadequate in today's climate, and a return on equity that is more than two hundred basis points below a fair return on equity. OSBA goes further, proposing a return on equity for PECO that approaches three hundred basis points below a fair return on equity. PECO MB at 54.

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

> The investment community would be very concerned if the Commission were to adopt any of the positions of the OCA or

602 *See* PECO St. 5; PECO St. 5-R; PECO Exhibit PRM-1 (updated), Schedule 1.

> OSBA. If it were to do so, investors would see Pennsylvania regulation as less supportive of the Company at a time of high levels of capital investment. At present, Pennsylvania regulation is currently ranked Above Average/3 by Regulatory Research Associates ("RRA"), which reflects an upgrade that occurred on May 10, 2017. The rating system used by RRA includes three principal categories (i.e., Above Average, Average and Below Average with more refined positions within the categories designated by the numbers 1, 2 and 3).
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> If the Commission were to follow the proposals of OCA or OSBA, the regulatory ranking of Pennsylvania would certainly be jeopardized. The return on equity used by the Commission to set rates should embody in a single numerical value a clear signal of regulatory support for the financial strength of the utilities that it regulates. Although cost allocations, rate design issues, and regulatory policies relative to the cost of service are important considerations, the opportunity to achieve a reasonable return on equity represents a direct signal to the investment community of regulatory support (or lack thereof) for the utility's financial strength. In a single figure, the return on equity utilized to set rates provides a common and widely understood benchmark that can be compared from one company to another and is the basis by which returns on all financial assets (stocks – both utility and non-regulated, bonds, money market instruments, and so forth) can be measured. So, while varying degrees of sophistication are required to interpret the meaning of specific Commission policies on technical matters, the return on equity figure is universally understood and communicates to investors the types of returns that they can reasonably expect from an investment in utilities operating in Pennsylvania.[603]

PECO MB at 54-55.

The Company maintains that the derivation of its proposed capital structure, return on equity, cost of debt, and overall rate of return are set in a fair manner that is consistent with the Commission's standards. The Company further maintains that there are numerous flaws in the analyses proffered by OCA, OSBA, and I&E. PECO MB at 55.

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

b. Capital Structure

The Company's capital structure is 53.38% common equity and 46.62% long-term debt, which represents its projected capital structure as of June 30, 2022, the end of the FPFTY.[604] PECO witness Moul explains that if an operating public utility raises its own debt directly in the capital markets, as PECO does, the operating public utility's own capital structure ratios should be used to determine its overall rate of return.[605] Accordingly, Mr. Moul started with the Company's actual capital structure as of June 30, 2020, which is the end of the HTY.[606] Then, adjustments were made by Mr. Moul to reflect events that will occur during the FTY and FPFTY and impact the cost of debt, including the Company's plans to issue new long-term debt in March 2021, September of 2021, and March 2022; a debt maturity that will occur in September 2021; planned future equity financings; the build-up of retained earnings; and the redemption of high-cost long-term debt and preferred stock.[607] PECO MB at 55.

PECO notes that the only party that opposes the Company's proposed capital structure is OCA, as I&E accepted the Company's proposed capital structure and OSBA does not comment on the capital structure ratio.[608] OCA's witness O'Donnell argued that the Company should use a hypothetical capital structure of 50% equity and 50% long-term debt for ratemaking purposes instead of the Company's actual capital structure.[609] Mr. O'Donnell references several sources in support of OCA's position: (i) a calculation of the average equity ratio of companies in Mr. O'Donnell's proxy group; (ii) the equity ratio in the capital structure of PECO's parent company, Exelon; (iii) the average equity ratio allowed by state regulators across the country in 2019; and (iv) the average equity ratio allowed by state regulators from 2005-2019.[610] Mr. O'Donnell asserts that these alternative measures demonstrates that PECO's actual equity ratio of 53.38% is unreasonable for ratemaking purposes.[611] PECO MB at 56; PECO RB at 37.

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604 PECO St. 5, pp. 18-19; PECO Ex. PRM-1 (updated), Schs. 1 and 5.
605 PECO St. 5, p. 18.
606 PECO Ex. PRM-1 (updated), Sch. 5.
607 *See id.*; PECO St. 5, pp. 18-19.
608 I&E St. 2, p. 12.
609 OCA St. 3, p. 44.
610 *Id.*, pp. 39-42.
611 *Id.*, p. 43.

PECO argues that the OCA's position is refuted in the rebuttal testimony of Mr. Moul.[612] As Mr. Moul explains, Mr. O'Donnell does not substantiate his approach except to demonstrate that it would lead to a lower revenue requirement. Mr. O'Donnell's capital structure proposal has no relationship to the actual financial risk of the Company, but instead represents a generic capital structure that would apply to any and all gas utilities.[613] Moreover, Mr. O'Donnell advocates a hypothetical debt ratio without using a hypothetical cost of debt related to the rate case decisions he relied upon.[614] As a consequence Mr. O'Donnell's proposal would provide PECO with a lower return on equity that is not commensurate with its actual financial risk.[615] PECO MB at 56.

Further, OCA's proposal to reference Exelon's capital structure would result in a mismatch between the applied capital structure and PECO's actual financial risk. Exelon's financial risks are different from PECO's because Exelon is a holding company, and its capital structure thus reflects the financial risk associated with ownership of multiple utilities, a large generation company, and significant unregulated competitive businesses.[616] PECO MB at 56-57.

There is no basis to adopt OCA's proposal to substitute a hypothetical capital structure for the Company's actual capital structure to set the rate of return in this case. The actual common equity ratio for PECO is well within the range of reasonableness, as the common equity ratios for Mr. Moul's comparison group of utilities include ratios that extend up to 62.4% for the year 2019.[617] Indeed, PECO's actual equity ratio is even within the ranges of the common equity ratios in the comparison groups of OCA witness O'Donnell and I&E witness Christopher Keller, which extend up to 62.30% and 59.01%, respectively.[618] On these facts, Commission policy requires the use of the company's own capital structure for ratemaking purposes. The Commission's policy is explained in *PPL 2012*:

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612 PECO St. 5-R, pp. 5-8.
613 *Id.*, p. 8.
614 *Id.*
615 *Id.*
616 PECO St. 5-R, p. 8.
617 PECO St. 5-R, pp. 5-6.
618 PECO St. 5-R, pp. 6-7; OCA St. 3, p. 40; I&E St. 2, p. 12.

> 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.[619]

PECO MB at 57.

This fundamental policy was reaffirmed by the Commission less than a month ago. As the Commission explained in *Columbia Gas*, the legal standard in Pennsylvania for deciding whether to use a party's proposed hypothetical capital structure in setting rates is that if a utility's actual capital structure is within the range of a similarly situated barometer group of companies, rates are set based on the utility's actual capital structure.[620] In applying this standard in *Columbia Gas*, the Commission found the utility's actual capital structure to be acceptable for ratemaking where its equity ratio fell below the upper most equity ratios of the companies in the barometer group.[621] PECO maintains that its equity ratio falls within the ranges of the common equity ratios in the comparison groups of OCA witness O'Donnell and I&E witness Keller, which extend up to 62.30% and 59.01%, respectively.[622] Accordingly, PECO believes it is appropriate to use PECO's actual capital structure for ratemaking purposes. PECO MB at 57-58.

c. Cost of Long-Term Debt

PECO's proposed embedded cost of long-term debt, updated by PECO witness Moul with data as of December 2020, is 3.84% for the FPFTY.[623] Mr. Moul computed the weighted average embedded cost rates of PECO's long-term debt as of the end of the HTY, FTY and FPFTY, respectively.[624] Mr. Moul then accounted for the Company's early redemption of high cost debt and for the future debt issues of the Company in 2021 and 2022.[625] The Company's long-term debt cost of 3.84% is also the basis for the 46.62% long-term debt ratio

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619 *PPL 2012*, p. 68 (citations omitted).
620 *Columbia Gas*, p. 116.
621 *Id.*, pp. 117-118.
622 PECO St. 5-R, p. 6; OCA St. 3, p. 40; I&E St. 2, p. 12.
623 PECO Ex. PRM-1 (updated), Sch. 6, pp. 1-3.
624 PECO St. 5, pp. 21-22.
625 *Id*.

used in the capital structure.[626] I&E accepted the Company's proposed cost of long-term debt and OSBA does not comment on the capital structure ratio. OCA initially challenged the Company's original proposed cost of long-term debt, which was 3.97% based on data ending June 2020, but OCA accepts the Company's updated calculation of its long-term debt cost at 3.84%.[627] Thus, no party opposes the Company's proposed long-term debt cost. PECO MB at 58; PECO RB at 39.

d. Common Equity Cost Rate

As PECO witness Moul explains, the use of more than one method provides a superior foundation to arrive at the cost of equity because at any point in time, any single method can provide an incomplete measure of the cost of equity depending upon extraneous factors that may influence market sentiment.[628] Moreover, in considering cost of equity methodologies, the Commission has recognized that "[s]ole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking."[629] To determine the fair common equity cost rate for the Company, Mr. Moul first determined the barometer group of companies based on their comparable risk to the Company. Next, Mr. Moul calculated the indicated cost of equity using four separate, well-established cost of equity methods: the DCF methodology, the Risk Premium approach, the Capital Asset Pricing Model ("CAPM"), and the Comparable Earnings method. Updated with data as of December 31, 2020, the results of those methods indicated the following equity cost rates:[630]

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

PECO MB at 59.

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626 PECO St. 5, p. 22.
627 OCA St. 3-SR, pp. 14-15.
628 PECO St. 5, pp. 6-7.
629 *2012 PPL* Order, p. 80.
630 PECO Ex. PRM-1 (updated), Sch. 1, p. 2.

Mr. Moul determined that the cost of equity in this case should be near the lower end of the range of results shown by the market-based models (i.e., DCF, Risk Premium and CAPM) due to the uncertainty associated with the COVID-19 pandemic.[631] Mr. Moul concluded that the base cost of equity should be 10.70%, as it rests between the lower end of the range (i.e., 10.25%) and midpoint of the range (i.e., 11.50%).[632] The base cost of equity is adjusted by a 25-basis point adder in recognition of the Company's superior management performance.[633] This results in PECO's proposed cost of equity, which is 10.95%. PECO MB at 60; PECO RB at 39.

PECO maintains that 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.[634] 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. PECO RB at 39-40.

i. Development of the Barometer Group

Mr. Moul developed the barometer group (referred to by Mr. Moul as the "Gas Group") by beginning with the ten gas utilities in *The Value Line Investment Survey* (*Value Line*), and eliminating UGI Corporation due to its dissimilarities in financial risk to the other companies in the barometer group.[635] UGI Corporation is more diversified outside of the gas distribution business than the other companies in the Gas Group, as UGI Corporation reports financial results for six separate segments consisting of propane sales, two international liquefied

[631] PECO St. 5, p. 7.
[632] *Id.*, pp. 7-8.
[633] *Id.*
[634] *See* OSBA M.B., p. 5.
[635] PECO St. 5, p. 6.

petroleum gas businesses, energy services and electric generation, in addition to its natural gas utility business.[636] PECO MB at 60.

Once UGI Corporation is properly excluded, the resulting nine companies in the Gas Group are: Atmos Energy Corp.; Chesapeake Utilities Corp.; New Jersey Resources Corp.; NiSource Inc.; Northwest Natural Holding Company; ONE Gas, Inc.; South Jersey Industries, Inc.; Southwest Gas Holdings, Inc.; and Spire, Inc.[637] Mr. Moul's Gas Group is identical to the barometer group used in the Bureau of Technical Utility Services' (TUS) cost of equity models in the Quarterly Earnings Report (Docket No. M-2020-3020940) that was approved by the Commission on January 14, 2021.[638] PECO MB at 60-61.

1. Dividend Yield

The dividend yield reveals the portion of investors' cash flow that is generated by the return provided by the dividends an investor receives.[639] The dividend yield is measured by the dividends per share relative to the price per share.[640] PECO MB at 61.

In his original analysis, which covered the period of May 2019 to June 2020, PECO witness Moul calculated average dividend yields for the Gas Group based upon a calculation using annualized dividend payments and adjusted month-end stock prices. In his original analysis, Mr. Moul identified a 3.28% dividend yield for the Gas Group.[641] In his updated analysis for the period ending December 31, 2020, the twelve-month average dividend yield was 3.36%, the six-month average was 3.65% and the three-month average was 3.65%.[642] However, for the purpose of a DCF calculation, the average dividend yield must be adjusted to reflect the prospective nature of the dividend payments, i.e., the higher expected dividends for

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636 *Id*.
637 PECO Ex. PRM-1, Sch. 3, p. 2.
638 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).
639 PECO St. 5, p. 24.
640 *Id*.
641 PECO Ex. PRM-1, Sch. 7.
642 PECO Ex. PRM-1 (updated), Sch. 7.

the future.[643] Accordingly, Mr. Moul adjusted the six-month average dividend yield in his update with three different, but generally accepted, manners and calculated the average of the three adjusted values.[644] In his updated analysis, this adjustment adds fourteen basis points to the three-month average dividend yield, yielding an adjusted dividend yield of 3.79%.[645] PECO MB at 61-62; PECO RB at 42.

PECO notes that 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.[646] PECO argues that 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. PECO RB at 42.

PECO asserts that 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: "[f]or 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 must reflect investors' anticipated cash flows."[647] 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".[648] PECO RB at 42-43.

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643 PECO St. 5, p. 25.
644 *Id*.
645 PECO Ex. PRM-1 (updated), Sch. 7.
646 OCA M.B., p. 115.
647 PECO St. 5, p. 25.
648 PECO St. 5, p. 25; PECO Ex. PRM-1, Sch. 7.

2. Growth Rate

PECO witness Moul used projected earnings per share growth rates taken from analysts' five-year forecasts compiled by IBES/First Call, Zacks, and *Value Line*, which are reliable authorities that investors use to make buy, sell and hold decisions.[649] For purposes of the DCF model, Mr. Moul selected a growth rate of 7.50% as a reasonable estimate of investor-expected growth for the Gas Group.[650] This value is within the array of analysts' forecasts of five-year earnings per share growth rates and below the midpoint of that data set.[651] PECO MB at 62.

OCA witness O'Donnell criticizes Mr. Moul's growth rate, arguing that relying solely upon forecasted EPS growth rates without taking into account historical growth rates, produces unrealistically high return on equity numbers.[652] However, using historic growth rates is inconsistent with the DCF methodology, as Mr. Moul explains. Moreover, historical data is already factored into analysts' forecast of earnings growth, and if analyzed separately, historical data would be double counted.[653] To properly reflect investor expectations within the limitations of the DCF model, earnings per share growth, which is the basis for the capital gains yield and the source of dividend payments, must be given greatest weight.[654] The reason that earnings per share growth is the primary determinant of investor expectations rests with the fact that the capital gains yield (i.e., price appreciation) will track earnings growth with a constant price earnings multiple (a key assumption of the DCF model).[655] Moreover, Professor Myron Gordon, the foremost proponent of the DCF model in public utility rate cases, has established that the best measure of growth for use in the DCF model are forecasts of earnings per share growth.[656] PECO MB at 62-63.

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649 PECO St. 5 at 30.
650 *Id*., p. 32; PECO St.5-R, p. 21.
651 PECO St. 5, p. 32.
652 OCA St. 3, p. 100.
653 PECO St. 5, p. 28.
654 PECO St. 5-R, p. 25.
655 *Id*.
656 *Id*., p. 26.

PECO further notes that 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.[657] 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%.[658] PECO RB at 43-44.

3. Leverage Adjustment

In the regulatory rate setting process, the DCF methodology is applied to the utility's capital structure, which is founded upon the utility's book value capitalization. In actuality, a firm's capitalization, as measured by its stock price, may diverge from its book value capitalization.[659] In that case, there is a financial risk difference between the capital structures because a market-valued capitalization contains more equity and less debt than a book-value capitalization and, therefore, has less risk than the book value capitalization.[660] 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.[661] This adjustment — i.e., the leverage adjustment — is needed to synchronize the financial risk of the book capitalization with the required return on the book value of the firm's equity.[662] PECO MB at 63.

PECO witness Moul calculated a leverage adjustment of 1.96%.[663] Using the standard Modigliani & Miller formulas, the equity return applicable to the book value common

657 PECO St. 5-R, pp. 22-23.
658 PECO St. 5-R, p. 24.
659 PECO St. 5, p. 32.
660 PECO St. 5, p. 32.
661 *Id*.
662 *Id*. at 33.
663 PECO St. 5, pp. 35-36; Ex. PRM-1 (updated), Schedule 10.

equity ratio is equal to 8.63%, which is the return for the Gas Group appropriate for a capital structure with no debt (i.e., a 100% equity ratio) plus 4.11% to compensate investors for the risk of a 48.57% debt ratio.[664] Under this approach, the parts sum to 12.74% (8.63% + 4.11% + 0.00%). To express this same return in the context of the DCF model, Mr. Moul summed the 3.28% dividend yield, the 7.50% growth rate, and 1.96% for the leverage adjustment in order to arrive at the same 12.74% (3.28% + 7.50% + 1.96%) return.[665] PECO MB at 63-64.

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*.[666] The OCA makes a similar argument, but instead references the Commission's decision in *UGI Electric 2018*.[667] 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.[668] PECO maintains, however, that 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.[669] 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 *not precedential* but discretionary with the Commission."[670] Thus, Commission precedent does not support the OCA's and I&E's position. PECO RB at 44-45.

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664 *Id*.
665 *Id*.
666 I&E M.B., p. 59.
667 OCA M.B., p. 117.
668 *Id*.
669 *Pa. Pub. Util. Comm'n v. Pa. Am. Water Co*., Docket No. R-00016339 (2002) (approving 60 basis point adjustment); *Pa. Pub. Util. Comm'n v. Phila. Suburban Water Co*., Docket No. R-00016750 (2002) (approving 80 basis point adjustment); *Pa. Pub. Util. Comm'n v. Aqua Pa., Inc.*, Docket No. R-00038805 (2004) (approving 60 basis point adjustment); *Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp*., Docket No. R-00049255 (2004); *Pa. Pub. Util. Comm'n v. PPL Gas Utils. Corp*., Docket No. R-00061398 (Order dated Feb. 8, 2007) ("*PPL Gas 2007*") (approving 70 basis point adjustment); *Pa. Pub. Util. Comm'n v. Pa. Am. Water Co*., Docket No. R-0001639 (Order dated Jan. 10, 2012) (approving 60 basis point adjustment).
670 *UGI Electric 2018*, p. 93 (emphasis added).

PECO maintains that 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."[671] 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."[672] PECO RB at 45.

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.[673] 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%.[674] Under these circumstances, Mr. Moul explained that he calculated a leverage adjustment with respect to the barometer group.[675] 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. PECO RB at 45-46.

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

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671 *Id.*
672 *PPL Electric 2012*, p. 91.
673 PECO M.B., p. 63.
674 PECO Ex. PRM-1, Sch. 10.
675 PECO St. 5, pp. 35-36; PECO Ex. PRM-1, Sch. 10.

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.[676] PECO RB at 46.

ii. Capital Asset Pricing Methodology

The CAPM uses the yield on a risk-free interest-bearing obligation plus a rate of return premium that is proportional to the systematic risk of an investment.[677] To compute the cost of equity with the CAPM, three components are necessary: (1) a risk-free rate of return ("Rf"); (2) the beta measure of systematic risk ("β"); and (3) the market risk premium ("Rm-Rf") derived from the total return on the market of equities reduced by the risk-free rate of return. *Id*. As shown on Ex. PRM-1, Schedule 1, Mr. Moul's calculation of the CAPM and results are summarized as follows:

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

The risk-free rate of return (*RF*), updated with data ending December 31, 2020, is 2.00%. Mr. Moul determined the risk-free rate of return based upon Blue Chip forecasts indicating the yields on long-term Treasury bonds during the next six quarters.[678] PECO MB at 64.

To determine the beta measure (β), Mr. Moul began with *Value Line* betas. However, *Value Line* betas are reflective of financial risk associated with market value capital structures and accordingly must be adjusted in order to be applicable to a book-value capital structure.[679] Mr. Moul used the Hamada formula, which is $\beta l = \beta u\ [1 + (1 - t)\ D/E + P/E]$, to unleverage and re-leverage the *Value Line* betas and make them suitable for application to a book-value capital structure.[680] In the Hamada formula, ßl = the leveraged beta, ßu = the

676 PECO M.B., p. 75.
677 PECO St. 5, p. 42.
678 PECO St. 5, pp. 45-46.
679 PECO St. 5, p. 43.
680 *Id*.

unleveraged beta, t = income tax rate, D = debt ratio, P = preferred stock ratio, and E = common equity ratio.[681] Mr. Moul's calculations of the Hamada formula are shown in Ex. PRM-1, Schedule 10, and, updated with data as of December 31, 2020, support a leveraged beta of 1.10 for the book value capital structure of the Gas Group.[682] PECO MB at 64-65.

The market premium (*Rm-Rf*) is derived from historical data and the forecast returns. Mr. Moul calculated a historically-based market risk premium of 9.04% based upon data of historical average large stock returns and average yields on long-term government bonds.[683] Mr. Moul then calculated a market risk premium of 9.16% based on data of the total market return from *Value Line* data and a DCF return for the S&P 500.[684] Averaging the market risk premium based on historic data (9.04%) with the market risk premium using forecasted data (9.16%) yields a market premium of 9.10%.[685] When updated based upon data ending December 31, 2020, the market premium declines to 8.77%.[686] PECO MB at 65.

To fully reflect the rate of return on equity, the CAPM must incorporate a size adjustment relating to the size of the company or portfolio for which the calculation is performed.[687] This is necessary due to the fact that as the size of a firm decreases, its risk and required return increases.[688] Without a size adjustment, the CAPM could understate the cost of equity significantly according to a company's size.[689] Reviewing historical data of the return in excess of the risk-free rate for mid-cap, low-cap, and micro-cap size firms, Mr. Moul selected a mid-cap adjustment of 1.02% in light of the market capitalization of the Gas Group.[690] PECO MB at 65-66.

PECO asserts that there are numerous flaws in the CAPM analyses of the OCA and I&E. PECO maintains that the OCA incorrectly used the geometric mean in its historic

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681 *Id*.
682 PECO Ex. PRM-1; PECO St. 5, pp. 43-44.
683 PECO St. 5, p. 46-47.
684 *Id*.
685 *Id*.
686 PECO Ex. PRM-1 (updated), Sch. 1, p. 2; *id*., Sch. 13, p. 2.
687 PECO St. 5, p. 47.
688 *Id*.
689 *Id*.
690 *See id*., pp. 47-48; PECO Ex. PRM-1, Sch. 13, p. 3.

analysis of the total market returns. PECO further asserts that 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. And neither the OCA nor I&E incorporate a size adjustment in their CAPM analyses, thereby rendering their analyses understated and inappropriate. PECO RB at 46.

iii. Risk Premium Approach

Under the Risk Premium approach, the cost of equity capital is determined by corporate bond yields plus a premium to account for the fact that common equity is exposed to greater investment risk than debt capital.[691] The cost of equity (i.e., "k") is represented by the sum of the prospective yield for long-term public utility debt (i.e., "i"), and the equity risk premium (i.e., "RP"). The Risk Premium approach provides a cost of equity of 10.00%.[692] Mr. Moul's calculation of the Risk Premium approach is summarized as follows:

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

PECO MB at 66.

The long-term public utility debt cost rate (*i*) is developed through estimating the prospective yield on long-term A-rated public utility bonds.[693] Mr. Moul's analysis of the historical yields on the Moody's index of long-term public utility debt shows that 1.75% is a reasonable spread for the yield on A-rate public utility bonds over Treasury bonds.[694] Mr. Moul then considered forecasted yields on long-term Treasury bonds from Blue Chip Financial Forecasts. Combining the forecasted Treasury bond yield data with the 1.75% spread resulted in values ranging from 3.25% to 3.65% and indicated a 3.50% yield on A-rate public utility bonds to be a reasonable benchmark.[695] Updating this calculation with data as of December 31, 2020, Mr. Moul determined that this benchmark declined to 3.25%.[696] PECO MB at 66.

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691 PECO St. 5, p. 38.
692 PECO Ex. PRM-1 (updated), Sch. 1.
693 PECO St. 5, p. 39-40.
694 *Id*.
695 *Id*., p. 40.
696 Ex. PRM-1 (updated), Sch. 1, p. 2.

To develop an appropriate equity risk premium (*RP*), Mr. Moul analyzed the results from 2020 SBBI Yearbook, Stocks, Bonds, Bills and Inflation.[697] The historical data demonstrates that the equity risk premium varies according to the level of interest rates, increasing as interest rates decline, and declining as interest rates increase.[698] In particular, the equity risk premium was 6.70% when the marginal cost of long-term government bonds was low (i.e., 2.88%), and the equity risk premium was 4.69% when the marginal cost of long-term government bonds was high (i.e., 7.09%).[699] Mr. Moul utilized a 6.75% equity risk premium.[700] The equity risk premium of 6.75% that Mr. Moul selected is near the risk premiums associated with low interest rates.[701] Combining this equity risk premium with the 3.25% prospective yield for long-term public utility debt results in a Risk Premium cost of equity estimate of 10.00%.[702] PECO MB at 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.[703] PECO maintains that 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. PECO RB at 47.

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.

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697 PECO St. 5, p. 41.
698 *Id*.
699 *Id*.
700 *Id*.
701 *Id*.
702 PECO St. 5, p. 42; PECO St. 5-R, p. 40.
703 I&E St. 2, pp. 18-19; OCA St. 3, p. 16; 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.[704] PECO maintains that the use of forecasts accommodates the reality that the future will diverge from current circumstances to some degree.[705] PECO RB at 47.

iv. Comparable Earnings Method

The Comparable Earnings (CE) method estimates a fair return on equity by comparing returns realized by non-regulated companies to returns that a public utility with similar risks characteristics would need to realize in order to compete for capital.[706] Since regulation is a substitute for competitively determined prices, the returns realized by non-regulated firms with comparable risks to a public utility provide useful insight into investor expectations for public utility returns.[707] PECO MB at 67.

The underlying premise of the CE method is that regulation should emulate results obtained by firms operating in competitive markets and that a utility must be given an opportunity cost of capital equal to that which could be earned if one invested in firms of comparable risk.[708] The CE method is consistent with the United States Supreme Court's holding in *Bluefield Water Works vs. Public Service Commission*, 262 U.S. 679, 692-93 (1923), regarding the return that a utility is entitled to:

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

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704 PECO St. 5-R, p. 41.
705 *Id*.
706 PECO St. 5 at 48.
707 *Id*.
708 PECO St. 5-R, pp. 41-42.

> enable it to raise the money necessary for the proper discharge of its public duties.

PECO MB at 67-68.

Mr. Moul applied the CE Method to non-regulated companies in order to avoid the circular reasoning implicit in the use of the achieved earnings/book ratios of other regulated firms.[709] To ensure that the firms selected for his analysis would have similar risk traits to a public utility, Mr. Moul used the following screening criteria: Timeliness Rank, Safety Rank, Financial Strength, Price Stability, *Value Line* betas, and Technical Rank.[710] The firms remaining after application of the screening criteria comprised the "Comparable Earning Group."[711] PECO witness Moul used historical realized returns and forecasted returns for the firms within the Comparable Earnings Group.[712] In order to cover conditions over an entire business cycle, Mr. Moul used a ten-year period (five historical years and five projected years).[713] Mr. Moul then disregarded the results of "highly profitable" firms, which he determined were those that have returns of 20% or greater.[714] Averaging the historical and forecasted rates of return on common equity for the remaining firms yielded a CE Method result of 12.90%, updated to 12.00% with data ending December 31, 2020.[715] PECO MB at 68.

e. Business Risks and Management Performance

Section 523 of the Public Utility Code provides for the Commission to consider management effectiveness in setting rates: PECO MB at 68.

> The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and

709 PECO St. 5 at 49, 51.
710 *Id*., p. 50; Exhibit PRM-1 (updated), Sch. 14, p. 3.
711 PECO St. 5, p. 50.
712 PECO St. 5, p. 51.
713 *Id*., p. 51.
714 *Id*. at 51.
715 *Id*., Exhibit PRM-1 (updated), Sch. 1, p. 2.

> appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.[716]

In prior cases, the Commission also has adjusted upward the cost of equity to reflect management effectiveness.[717] PECO MB at 69.

PECO witness Bradley's direct and rebuttal testimony details the numerous improvements the Company has made in its service, making it eligible for an enhancement to its return on equity for its management performance. Based on Mr. Bradley's evidence, PECO witness Moul concludes that the Company should receive a 0.25% adder for strong management performance.[718] PECO MB at 69.

PECO notes that it has engaged in substantial efforts to eliminate potential environmental concerns at its former MGP sites. Once remediated, the sites may be used for various beneficial land-use purposes that otherwise would not be permitted.[719] PECO MB at 69.

PECO argues that it has successfully managed its natural gas distribution system in a safe and responsible manner in order to ensure pipeline reliability while meeting or exceeding all requirements of the pipeline safety regulations (49 C.F.R. Part 192) and the applicable provisions of the Pennsylvania Code (Title 52, Chapter 59).[720] Looking forward, PECO has implemented a number of important initiatives and technological improvements focused on safety and reliability, including: (i) actively enhancing its mapping system using modern technology to integrate with our Geographic Information System (GIS); (ii) utilization of marker balls, which are buried alongside underground facilities, to provide an accurate, convenient and long-lasting means to identify specific locations on PECO's gas distribution system, including valves, dead ends, leaks, or places where pipe changes directions; (iii)

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716 66 Pa.C.S. § 523(a).

717 *UGI Electric 2018*, p. 119; *PPL* 2012, pp. 97-99; *Pa. Pub. Util. Comm'n v. Aqua Pa., Inc*., Docket No. R-00072711, 2008 Pa. PUC LEXIS 50 at *63 (Jul. 31, 2008) ("*2008 Aqua Order*").

718 PECO St. 5, p. 52.

719 PECO St. 1, pp. 13-14.

720 *Id*., p. 15.

implementation of improved measures to avoid occurrences of incidental cross-boring with another existing utility; and (iv) recent initiation of a natural gas reliability project in Delaware and Montgomery counties to meet the growing needs and demands of PECO customers.[721] PECO MB at 69-70.

Additionally, Mr. Bradley described several recent PECO initiatives to improve its customer service. For example, PECO expanded its communications capabilities so customers can interact with the Company using mobile devices. PECO deployed a mobile application with features such as slide-to-pay (by credit card and e-check), outage reporting, and the ability to enroll in electronic billing, automatic payments, and budget billing. The Company also added a two-way outage text feature that enables customers to text "OUT" to report an outage and "STAT" to receive an outage status update.[722] The Company also has plans to further enhance customer service, including plans for: (i) additional customer service representative coaching and training to improve the customer experience and resolve the customer's questions during the first call ("First Call Resolution"); (ii) an operational metric to track First Call Resolution; and (iii) improved web and mobile capabilities to provide customers additional options for self-service.[723] PECO MB at 70.

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

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

[721] *Id.*, pp. 16-18.
[722] *Id.*, p. 20.
[723] *Id.*, p. 22.

Indeed, the PECO customer experience, as measured by J.D. Power, has improved from a score of 726 to 748, resulting in PECO's customer service ranking among comparative utility companies increasing from 7th out of 12 in 2017 to 4th out of 12 in 2019.[724] PECO MB at 71.

f. Other Parties' Equity Cost Rate Recommendations and Principle Areas of Dispute

OSBA does not propose a specific cost of equity return rate for PECO, but argues that, generally, the relative risk of regulated natural gas utilities implies a cost of equity capital well below 8%.[725] OSBA witness Robert D. Knecht bases this conclusion upon information that Duff & Phelps lowered its overall average risk cost of equity capital to 8.0 percent, and his opinion that natural gas utilities have a lower than average risk.[726] Mr. Knecht declines to offer any analysis using the standard models employed by Mr. Moul. Mr. Knecht also criticizes the DCF model as having significant disadvantages in its use of forecasted growth rates and the inherent perpetual growth rate assumption.[727] PECO MB at 71.

PECO maintains that OSBA's analysis would significantly understate the cost of common equity for PECO. As Mr. Moul explained, OSBA's proposal using returns published by Duff & Phelps have no relationship to PECO and cannot be used to set the cost of equity.[728] Moreover, Commission precedent has long relied on cost of equity models like the ones used by Mr. Moul, and clearly favors the use of the DCF methodology as a primary tool to be used in setting the cost of equity rate.[729] PECO MB at 71-72.

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[724] PECO St. 1, p. 22.
[725] OSBA St. 1, pp. 7-8.
[726] *Id*.
[727] *Id*., pp. 9-10.
[728] PECO St. 5-R, p. 43.
[729] *See*, *e.g.*, *Columbia Gas*, p. 131 (finding that "the Company's cost of equity in this proceeding should primarily be based upon the use of the DCF methodology and [. . . .] the results of the CAPM analysis should be used as a comparison to the DCF results").

I&E recommends an overall rate of return for PECO of 7.26%.[730] I&E's proposed capitalization is 53.38% common equity and 46.62% long-term debt. I&E proposes a long-term debt cost rate for PECO of 3.97% and a cost of common equity of 10.24%.[731] To develop the cost of common equity, I&E witness Keller proposes to use the DCF method as the primary method, with the results of the CAPM as a comparison.[732] Mr. Keller's DCF result is 10.24%. *Id*., p. 20. Mr. Keller's CAPM result is 9.08%.[733] Mr. Keller chose to exclude the Risk Premium and Comparable Earnings methods from his analysis of the Company's cost of capital.[734] PECO MB at 72.

PECO's dispute with I&E's analysis of the rate of return is centered on Mr. Keller's analyses of the cost of equity.

OCA recommends an overall rate of return for PECO of 6.30%.[735] OCA witness O'Donnell proposes a capital structure for PECO of 50.00% common equity and 50.00% long-term debt.[736] Mr. O'Donnell recommends a cost of common equity for PECO of 8.75%.[737] Mr. O'Donnell's cost of equity analysis is supported by a DCF analysis, CAPM analysis, and Comparable Earnings analysis. OCA witness O'Donnell calculates a DCF range of 7.75% to 10.00%, CAPM results that are between 5.50% and 7.75%, and Comparable Earnings results in the range of 9.25% to 10.25%.[738] PECO MB at 72-73.

PECO disagrees with numerous aspects of Mr. O'Donnell's analysis, particularly with regard to the capital structure and cost of common equity. PECO MB at 73.

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730 I&E St. 2, p. 48.
731 I&E St. 2, p. 6.
732 *Id*. p. 15.
733 *Id*., p. 27.
734 *Id*., pp. 18-19.
735 OCA St. 3, p. 127.
736 *Id*., p. 44.
737 *Id*., p. 88.
738 OCA St. 3, p. 87 and Exhibit KWO-1.

i. Barometer Group

PECO argues that OCA and I&E used incorrect barometer groups in their calculations of costs of equity for PECO. To develop his barometer group, OCA witness O'Donnell drew upon the ten gas utilities in *Value Line*, but Mr. O'Donnell erroneously did not exclude UGI Corporation as Mr. Moul did. UGI Corporation is more diversified outside of the gas distribution business than the other companies properly includible in the barometer group.[739] Separately from his barometer group, Mr. O'Donnell also evaluated Exelon Corporation as a measure of the cost of equity for PECO. However, reference to the parent corporation is inappropriate and inconsistent with Commission policy, which is to use a barometer group analysis to set the return on equity when the utility's own stock is not traded.[740] PECO MB at 73.

I&E witness Keller used a barometer group that is the same as Mr. Moul's Gas Group, except that Mr. Keller excluded New Jersey Resources and Southwest Gas Holdings by application of an additional criteria that excludes companies with less than a certain percentage of revenues devoted to utility operations. Mr. Moul explained why Mr. Keller's additional criteria for exclusions from the Barometer Group are improper: PECO MB at 73.

New Jersey Resources and Southwest Gas Holdings are appropriately included in the Barometer Group because their percentages of utility assets, as is the case for other members of Mr. Moul's Gas Group, are all above 60%, which demonstrates that all of the companies are primarily utility businesses.[741] PECO MB at 74.

Finally, as further support for using Mr. Moul's Barometer Group, the Commission itself used the same barometer group when applying the cost of equity models in its most recent Quarterly Earnings Report issued on January 14, 2021 at Docket No. M-2020-3023406. PECO MB at 74.

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739 PECO St. 5, p. 6.
740 PECO St. 5-R, p. 18.
741 *Id*., p. 19.

ii. DCF Methodology

PECO argues that the growth rate estimate used by I&E in the DCF methodology is flawed. The main problem in the DCF methodology of I&E Witness Keller is caused by an erroneous exclusion of a growth rate estimate. In particular, Mr. Keller excludes a *Value Line* estimate for Northwest Natural Gas, and then retains growth rates from other sources that are much too low (e.g., 1.65% by Yahoo for NiSource; 3.10% by Yahoo, 3.10% by Zacks and 2.80% by Morningstar for Northwest Natural).[742] The result is that Mr. Keller improperly ignores a high number while retaining unreasonably low numbers for one company, thereby introducing an unwarranted downward bias to his results. Although Mr. Keller asserts that the *Value Line's* growth rate projection for Northwest is extremely inconsistent, this is incorrect because it rests within the 5.67% to 11.10% range of growth rates for the other members of Mr. Keller's Barometer Group.[743] On the other hand, the 3.00% growth rates that Mr. Keller did retain for Northwest Natural is well below that range.[744] If Mr. Keller had used the *Value Line* estimate for Northern Natural Gas as he should have, the growth rate for his barometer group would have been 7.63%, leading to a more reasonable average DCF return of 11.01%.[745] PECO MB at 74-75.

PECO further asserts that OCA witness O'Donnell's DCF methodology is flawed due to the errors in his barometer group, discussed *supra*, and because his methodology fails to incorporate a leverage adjustment, which is needed to synchronize the financial risk of the book capitalization with the required return on the book value of the firm's equity.[746] Both I&E and OCA challenge the Company's leverage adjustments to the DCF and beta component of the CAPM. OCA witness O'Donnell criticizes the Company's leverage adjustment as a "market-to-book" adjustment. However, there is no aspect of the leverage adjustment calculated by Mr. Moul that provides a conversion of a DCF return based upon any particular market-to-book ratio, and this is true for the CAPM as well.[747] PECO MB at 75.

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[742] PECO St. 5-R, pp. 22-23.
[743] PECO St. 5-R, p. 23.
[744] PECO St. 5-R, p. 23.
[745] PECO St. 5-R, p. 24.
[746] PECO St. 5, p. 43.
[747] PECO St. 5-R, p. 31.

I&E witness Keller states that he opposes a leverage adjustment because the rating agencies use book value in their analysis.[748] However, this argument has no merit. The credit rating agencies are only concerned with the interests of lenders, and with a company's ability to make timely payments of principal and interest; the rating agencies do not measure the market-required cost of equity for a company.[749] In opposing the leverage adjustment, Mr. Keller also references several rate cases where the Commission declined to adopt a leverage adjustment.[750] Yet, the cases cited by Mr. Keller do not stand for a categorical rule excluding leverage adjustments. The Commission has accepted the leverage adjustment in a number of cases, including *Pa. Pub. Util. Comm'n v. PPL Gas Utils. Corp*., Docket No. R-00061398 (Order dated Feb. 8, 2007). In the *Aqua Pennsylvania* case cited by Mr. Keller, the Commission did not repudiate the leverage adjustment, but instead arrived at an 11.00% return on equity for Aqua by including a separate return increment for management performance. As Mr. Moul explains, the *City of Lancaster* case referenced by Mr. Keller is distinguishable because the leverage adjustment denied by the Commission in that case was calculated in an unsound manner by erroneously applying the Hamada formula to the DCF and Risk Premium methods.[751] PECO MB at 75-76.

iii. Capital Asset Pricing Methodology

PECO argues that the CAPM analyses of OCA and I&E significantly understate the cost of equity due to several errors: (i) I&E witness Keller's use of the yield on 10-year Treasury notes rather than longer-duration Treasury offerings, (ii) OCA witness O'Donnell's consideration of historical geometric means to calculate total market return, (iii) the failure of Messrs. Keller and O'Donnell to use leverage adjusted betas, and (iv) the failure of Messrs. Keller and O'Donnell to make a size adjustment. In addition, OCA witness O'Donnell's application of the CAPM is flawed due to its lack of a prospective yield on Treasury bonds and the derivation of a market risk premium that is unreflective of investor-expected returns. PECO MB at 76.

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748 I&E St. 2, p. 42.
749 PECO St. 5-R, pp. 28-29.
750 I&E St. 2, p. 4.
751 PECO St. 5-R, p. 30.

First, with respect to I&E witness Keller's use of 10-year Treasury notes rather than longer-duration Treasury offerings, Mr. Moul explains that long-term rates, such as those revealed by 30-year Treasury bonds, should be used to measure the risk-free rate of return.[752] The flaw in using 10-year Treasury notes is that they are more susceptible to monetary policy actions taken by the Federal Open Market Committee.[753] In contrast, 30-year Treasury bonds are more a reflection of investor sentiment of their required returns.[754] Furthermore, Mr. Keller's analysis significantly understates the risk-free rate of return because he incorrectly gives the same weight to the yield on 10-year Treasury notes for the first, second, third and fourth quarters of 2021 as he does for the entire five-year period 2022 through 2026.[755] PECO MB at 76-77.

Second, with respect to OCA's CAPM analysis, Mr. O'Donnell incorrectly used the geometric mean in his historic analysis of the total market returns.[756] As Mr. Moul explained, the theoretical foundation of the CAPM requires that the arithmetic mean be used because it conforms to the single period specification of the model and it provides a representation of all probable outcomes and has a measurable variance.[757] The necessity for an arithmetic mean is also recognized by Ibbotson.[758] Use of the geometric mean, which Mr. O'Donnell advocates, consists merely of a rate of return taken from two data points which would have no measurable variance.[759] PECO MB at 77.

As noted above, neither the OCA nor the I&E CAPM analyses incorporate a leverage adjustment to the CAPM beta, which is needed because the information underlying the betas are reflective of financial risk associated with market value capital structures. Accordingly, they must be adjusted in order to be applicable to a book-value capital structure.[760] PECO MB at 77.

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752 PECO St. 5-R, p. 32-33.
753 *Id*.
754 *Id*.
755 PECO St. 5-R, p. 33.
756 OCA St. 3, p. 83.
757 PECO St. 5-R, pp. 36-37.
758 *Id*., pp. 37-38.
759 *Id*., p. 37.
760 PECO St. 5, p. 43.

The OCA and I&E also incorrectly exclude a size adjustment in their CAPM analyses. I&E witness Keller disagrees with the size adjustment based upon his mistaken inference that Mr. Moul's calculation of a size adjustment did not take into account the public utility industry. However, Mr. Moul explains that this is incorrect and that he did consider the utility industry in his adjustment.[761] PECO MB at 77.

OCA witness O'Donnell also disregards the size adjustment, asserting that it results in double-counting.[762] This is incorrect. The size adjustment is necessary because the financial impact of changes in specific dollar amounts of revenues and costs have a magnified influence on a small company because there are fewer dollars over which those revenues or costs can be spread.[763] The inability of the simple, unadjusted CAPM to reflect the return associated with small size is recognized by financial experts.[764] Moreover, the size adjustment is accepted as necessary by regulatory agencies with expertise in this area, such as the FERC.[765] PECO MB at 77-78.

iv. Exclusion of Other Cost of Equity Models

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

> Sole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking. We conclude that methodologies other than the DCF can be used as a check upon the reasonableness of the DCF derived equity return calculation.[766]

PECO MB at 78.

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761 PECO St. 5-R, p. 35; PECO St. 5-SR, p. 2.
762 OCA St. 3, pp. 113-115.
763 PECO St. 5-R, p. 39.
764 *Id*.
765 *See, e.g., Ass'n of Businesses Advocating Tariff Equity*, Opinion No. 569-A, 171 FERC 61,154 at P 75 (2020) ("the size adjustment is necessary to correct for the CAPM's inability to fully account for the impact of firm size when determining the cost of equity.").
766 *PPL 2012*, p. 80 (citing *Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp.*, Docket No. R-00049255, at 67 (Order entered December 22, 2004)).

PECO argues that the I&E's and the OCA's criticisms of methodologies other than the DCF and CAPM are without merit. I&E witness Keller asserts that the Risk Premium method does not measure the current cost of equity as directly as the DCF, but this is incorrect; Mr. Moul incorporated current interest rates when he developed his Risk Premium cost of equity of 10.25%, and 10.00% as updated.[767] PECO MB at 78.

Mr. Keller claims the Risk Premium methodology is a simplified version of the CAPM, is subject to the same faults as CAPM, and "does not recognize company-specific risk through beta".[768] OCA witness O'Donnell similarly finds fault with the Risk Premium methodology and declines to use it. Mr. Moul's testimony refutes these objections. Mr. Moul explains that the Risk Premium methodology is an approach that provides a direct and complete reflection of a utility's risk and return because it considers additional factors not reflected in the beta measure of systematic risk.[769] Further, the Risk Premium approach provides for direct reflection of prospective interest rates in the model and therefore should be given weight in determining the equity cost rate in this case.[770] PECO MB at 78-79.

PECO argues that the criticisms of the Comparable Earnings approach by I&E and OCA are also unfounded. As discussed in Mr. Moul's testimony, the Comparable Earnings approach satisfies the comparability standard established in the *Hope* case that specifies that the return to the utility should provide it "with returns on investments in other enterprises having corresponding risks."[771] In addition, the financial community has expressed the view that the regulatory process must consider the returns that are being achieved in the non-regulated sector to ensure that regulated companies can compete effectively in the capital markets.[772] Moreover, the financial literature effectively demonstrates that ROEs from non-regulated companies provide better assessment of investor requirements than those available for regulated utilities.[773] PECO MB at 79.

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767 PECO St. 5-R, p. 40.
768 I&E St. 2, pp. 18-19.
769 PECO St. 5-R, pp. 40-41.
770 *Id*.
771 PECO St. 5-R, p. 42.
772 *Id*.
773 *Id*.

v. Management Performance

In response to PECO witness Bradley's testimony regarding PECO's exemplary management performance and PECO witness Moul's recommendation of a related increase in allowed return for that performance, I&E witness Keller asserted that PECO should not be rewarded for simply providing the service it is required to do by law. OCA witness O'Donnell went further, asserting that PECO's performance did not rise to an exemplary level and was driven in part by settlement commitments.[774]

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

> First, I certainly agree that we are required to provide reasonable, adequate and safe service as required by law, and we do that every day. But what we also do is deliver exemplary performance for our customers in several ways which Mr. O'Donnell simply ignores. He does not address our success in keeping annual growth in operation and maintenance expenses below 1.9 percent for a decade, 1.3 percent if increases in gas mapping and locating expense are removed, and that's without filing for a rate case, nor does he acknowledge our success in addressing gas odor responses or introducing new technologies across our operations. Contrary to his testimony, our deployment of these technologies is not due to the Penrose Lane settlement, where we have met all of our commitments. The settlement incorporated innovations that we were already developing and have been able to accelerate.
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> Second, with respect to J.D. Power scores, I certainly recognize that our significantly improved scores have not placed us at the top of the J.D. Power rankings. But I believe our success to date firmly demonstrates an exemplary approach of continued improvement with results that benefit our customers throughout our operations and should be appropriately recognized by the Commission.[775]

PECO MB at 79-80.

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[774] I&E St. 2-SR, pp. 34-36; OCA St. 2-SR, pp. 5-11.
[775] Tr. 218-219.

2. I&E's Position

a. Introduction

I&E recommends the following rate of returns[776] for PECO Gas:

Type of Capital	Ratio	Cost Rate	Weighted Cost
Long-Term Debt	46.62%	3.84%	1.79%
Common Equity	53.38%	10.24%	5.47%
Total	100.00%		7.26%

I&E MB at 51.

In utility ratemaking, the concept of rate of return enjoys the dubious status of being at once both well-documented legally and highly disputed factually. Simply stated, rate of return is the revenue an investment generates in the form of net income; and is generally expressed as a percentage of the amount of capital invested over a given period of time. It is a controversial component of the revenue requirement formula, although, as the Commission continues to clarify its position in this regard, rate of return is becoming less and less controversial.[777] I&E MB at 51.

I&E maintains that a fair and reasonable overall rate of return is one that will allow the utility an opportunity to recover those costs prudently incurred by all classes of capital used to finance the rate base during the prospective period in which its rates will be in effect.[778] I&E MB at 52-53; I&E RB at 31.

776 I&E St. No. 2-SR, p. 37.

777 For calculation of a utility's base rate revenue requirements, the formula used RR = E + D + T + (RB x ROR), where RR = Revenue Requirement; E = Operating Expense; D = Depreciation Expense; T = Taxes; RB = Rate Base; and ROR = Overall Rate of Return. I&E St. No. 2, p. 3.

778 I&E St. No. 2, pp. 3-4.

b. Capital Structure

I&E recommends using the Company's claimed capital structure as it falls within the range of the I&E proxy group's 2019 capital structures, which is the most recent information available at the time of I&E's analysis.[779] The 2019 range consists of long-term debt ratios ranging from 33.18% to 53.48% and equity ratios ranging from 32.78% to 59.01%, with a five-year average of 40.29% for long-term debt and 47.60% for common equity.[780] I&E MB at 53-54; I&E RB at 32.

c. Cost of Long-Term Debt

I&E recommends using the Company's updated claimed long-term debt cost rate of 3.84% for the FPFTY, which results in a weighted cost of debt of 1.79% or a decrease of 0.06% (1.85% - 1.79%) to the Company's original claim.[781] The Company's claimed cost rate of long-term debt is reasonable, as it is representative of the industry.[782] It falls within I&E's proxy group's implied long-term debt cost range of 3.14% to 5.82%, with an average implied long-term debt cost of 4.91%.[783] I&E MB at 54; I&E RB at 32.

d. Common Equity Cost Rate

I&E continues to recommend using the Discounted Cash Flow (DCF) method as the primary method to determine the cost of common equity.[784] Further, I&E recommends using the results of the Capital Asset Pricing Model (CAPM) as a comparison to the DCF results.[785] I&E's recommendation is consistent with the methodology historically used by the Commission in base rate proceedings, even as recently as 2017, 2018, and 2020.[786] And we can now add

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779 I&E St. No. 2, p. 12; I&E St. No. 2-SR, p. 10.
780 *Id.*, *citing* I&E Exh. No. 2, Sch. 2.
781 I&E St. No. 2-SR, p. 11, *citing* PECO St. No. 5-R, pp. 9-10.
782 I&E St. No. 2, p. 13.
783 *Id.*, *citing* I&E Exh. No. 2, Sch. 3.
784 I&E St. No. 2, p. 15.
785 *Id.*
786 *Id.*, pp. 15 (citation omitted).

Columbia Gas to the list.[787] In fact, this "issue" can now be relegated to the "well settled" category. The Commission noted, in *Columbia*:

> [W]e shall adopt the position of I&E and shall base our determination of the appropriate cost of equity on the results of the DCF method and shall use the CAPM results as a comparison thereto. As I&E noted, the use of the DCF model has historically been our preferred methodology and was recently affirmed in *UGI Electric*. Like the ALJ, we find no reason to deviate from the use of this method in the instant case.[788]

I&E MB at 54-55.

The result of I&E's DCF analysis is 10.24% while the result of I&E's CAPM analysis is 9.08%; both of which are significantly lower than the Company's claim of 10.95%.[789] It is unquestioned that the DCF method is the most reliable.[790] I&E always considered the fact that no method can perfectly predict the return on equity, which is why I&E also uses the CAPM as a comparison to the DCF.[791] As a result of I&E's DCF analysis I&E recommended a cost of common equity of 10.24%.[792] I&E MB at 55.

Both PECO and the OCA raised various issues relating to the cost of common equity calculations which were addressed and rejected in I&E witness Keller's surrebuttal testimony.[793] Therefore, in consideration of the above and the record evidence presented, I&E continues to recommend a cost of common equity of 10.24%.[794] I&E MB at 55; I&E RB at 32.

PECO continues to propose a cost of equity of 10.95%[795] which I&E rejects.[796] PECO also raised an issue regarding the development of the barometer (proxy) group.[797] But, as

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787 *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa. Inc.*, Docket No. R-2020-3018835 (Order Entered February 19, 2021).
788 *Id.*, p. 131.
789 I&E St. No. 2-SR, p. 12.
790 I&E St. No. 2, pp. 16-17; I&E St. No. 2-SR, p. 12.
791 I&E St. No. 2, pp. 24-27.
792 I&E St. No. 2, p. 20, *citing* I&E Exh. No. 2, Sch. 1.
793 I&E St. No. 2-SR, pp. 3-37.
794 *Id.*, p 37.
795 PECO MB, p. 60.
796 I&E MB, p. 56.
797 PECO MB, p. 60-61.

I&E noted, the Commission has stated its support for I&E's methodology for determining proxy groups in the recent *Columbia Gas* base rate proceeding.[798] I&E RB at 33.

PECO also raised issues regarding dividend yield, growth rate, and a leverage adjustment.[799] But, through the Commission's acceptance of the Recommended Decision's acceptance of I&E's Discounted Cash Flow methodology in *Columbia Gas*, I&E's methodology regarding the dividend yield and growth rate were accepted, while the company's proposed leverage adjustment was rejected.[800] Therefore, I&E continues to recommend a cost of common equity of 10.24%. I&E RB at 33.

e. Business Risks and Management Performance

I&E asserts that true management effectiveness is earning a higher return through its efficient use of resources and cost cutting measures.[801] The greater net income resulting from cost savings and true efficiency in management and operations is available to be passed on to shareholders.[802] PECO Energy, or any utility should not be awarded additional basis points for doing what they are required to do in order to provide adequate, efficient, safe, and reasonable service under 66 Pa. C.S.A. § 1501.[803] I&E MB at 56.

The Company argues that an additional 25 basis points should be added for "superior management performance."[804] PECO argues in support of its management performance claim that it operates various programs that promote high quality and reliability of service, commitment to energy efficiency, support for community and economic development in the Company's service territory, measures taken to protect the safety of workers, its significant

798 I&E MB, pp. 58-59. See *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa. Inc. ("Columbia Gas"),* pp. 121-131, Docket No. R-2020-3018835 (Order entered February 19, 2021).
799 PECO MB, pp. 61-64.
800 I&E MB, pp. 54-56. *See also*, *Columbia Gas*, pp. 123-124, 130-131.
801 I&E St. No. 2, pp. 47-48; I&E St. No. 2-SR, pp. 35-36.
802 *Id.*
803 *Id.*
804 PECO St. No. 5, p. 7.

efforts to manage and control its operating expenses, and the high quality of customer service that was recognized by J.D. Power.[805] I&E MB at 56.

I&E rejects the Company's arguments and asserts that by awarding the Company management effectiveness points, it will cost the customer money for the Company to provide the adequate, efficient, safe, and reasonable service that is required by the Public Utility Code and Commission regulations.[806] Further, even a modest increase in the cost of equity by an additional 25 basis points translates to an additional $3,285,458 that would flow through to the ratepayers.[807] Rather, any savings from effective operating and maintenance cost measures should flow through to ratepayers and investors.[808] These claimed savings would likely be offset by the addition of basis points for management effectiveness as ratepayers would have to fund the additional costs.[809] This defeats the purpose of cutting expenses to benefit ratepayers. Ensuring that these cost saving measures flow to ratepayers is especially important now as many have recently experienced reduced household income as a result of job loss or reduction in hours due to the global pandemic.[810] I&E MB at 56-57.

Finally, the Commission affirmed the Administrative Law Judge's denial of management performance points in *Columbia Gas*.[811] The Commission summarized the Recommended Decision and stated:

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

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805 *See* PECO St. No. 1, pp. 14-25.
806 I&E St. No. 2, p. 47.
807 *Id.*, p. 46.
808 I&E St. No. 2-SR, p. 35.
809 *Id.*
810 *Id.*, pp. 35-36.
811 *Columbia Gas*, Docket No. R-2020-3018835, p. 134 (Order Entered February 19, 2021).

effectiveness adjustment be made to the Company's cost of equity.[812]

I&E MB at 57.

Therefore, in consideration of the above and the record evidence presented, I&E urges that PECO Energy should not be awarded additional basis points for doing what they are required to do by the Public Utility Code and the Commission regulations in order to provide adequate, efficient, safe, and reasonable service.[813] I&E MB at 58.

f. Other Parties' Equity Cost Rate Recommendations and Principle Areas of Dispute

PECO and the parties raised multiple issues regarding I&E's cost of common equity calculations and recommendation that have been addressed and rejected in I&E witness Keller's surrebuttal testimony.[814] I&E MB at 58.

Regarding the proxy group issue,[815] the Commission in *Columbia Gas* just stated its support for I&E's methodology of determining proxy groups for rate of return analysis.[816] The Commission stated:

> On consideration of the record evidence in this proceeding, we shall adopt ALJ Dunderdale's recommendation that I&E's proxy group should be utilized in setting the appropriate rate of return for Columbia. … Rather, we find that I&E's proxy group of companies is the proxy group proffered in this proceeding that most closely resembles Columbia.
>
> First, as I&E and the ALJ pointed out, a company's revenues represent the percentage of cash flow the company receives from each business line related to providing a good or service. Therefore, if less than fifty percent of revenues come from the regulated gas sector, the company is not comparable to the subject

812 *Columbia Gas*, p. 134.
813 I&E St. No. 2, pp. 47-48; I&E St. No. 2-SR, p. 36.
814 I&E St. No. 2-SR, pp. 3-37.
815 *See* I&E St. No. 2, pp. 6-10; I&E St. No. 2-SR, pp. 5-9.
816 *Columbia Gas*, pp. 110-112.

utility as it does not provide a similar level of regulated business.[817]

I&E MB at 58.

Further, regarding the proposed leverage adjustment,[818] in *Columbia Gas* the Commission adopted the Recommended Decision which adopted I&E's position for determining the appropriate cost of equity.[819] And by adopting the Recommended Decision agreeing with I&E, the Commission rejected Columbia's proposed leverage adjustment as flawed.[820] I&E MB at 59; I&E RB at 35.

3. OCA's Position

a. Introduction

i. Overview of the Cost of Capital Recommendation

PECO seeks a 7.64% overall rate of return, including a cost of equity of 10.95%, and a cost of debt of 3.84%.[821] PECO presented the testimony of Paul R. Moul to support its rate of return request. Mr. Moul's cost of capital analyses include adjustments for leverage and size, which increase the models' result.[822] Mr. Moul has then added a 25 basis point increment to his indicated cost of equity to recognize management performance.[823] OCA MB at 73.

In response, the OCA presented the testimony of Mr. Kevin O'Donnell, an expert economic consultant specializing in utility regulation, to support its rate of return allowance. Mr. O'Donnell's primary position supports the recommendation of OCA witness Rubin.[824] Mr. O'Donnell's alternative recommendation provides the Commission with an analysis based upon

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817 *Id.*, at p. 110.
818 *See* I&E St. No. 2, pp. 37-42; I&E St. No. 2-SR, pp. 19-24.
819 *See Columbia Gas*, pp. 137-141.
820 *Id.*, p. 141.
821 PECO St. 5-R at 1, PECO Exh. PRM-1 (Updated), Sch. 1.
822 PECO St. 5 at 32-37, 42-48.
823 *Id*. at 2, 7-8, 52.
824 OCA St. 3 at 3-4, 126-127.

a "business as usual" approach with a market-derived cost of equity.[825] In determining an appropriate cost of capital, OCA witness O'Donnell rejected the Company's capital structure as comprised of too much equity and unfair to consumers.[826] Mr. O'Donnell recommends a capital structure of 50% debt and 50% common equity.[827] Mr. O'Donnell determined an 8.75% market-derived return on common equity and an overall return on rate base of 6.30%:[828]

Capital Type	Capital Structure Ratio (%)	Cost Rate (%)	Weighted Cost (%)
Long-Term Debt	50.00	3.84	1.92
Common Equity	50.00	8.75	4.38
Total	**100**		**6.30**

The 8.75% cost of equity recommended by Mr. O'Donnell is the result of his Discounted Cash Flow (DCF) analysis, and consideration of his Capital Asset Pricing Model (CAPM) and Comparative Earnings analyses.[829] OCA MB at 73-74.

The OCA submits that the Company's 10.95% cost of common equity request is well in excess of an objective assessment of investor market requirements in the current economic environment and should be rejected. Since the Company's last base rate case, long-term interest rates have fallen and the economic impact of the COVID-19 Pandemic and extraordinary public safety measures have manifested in higher unemployment and reduced household income to pay for basic necessities.[830] In addition, both OCA witness Mr. O'Donnell and I&E witness Keller testified the return on equity (ROE) adjustments proposed by Mr. Moul are inappropriate, unnecessary and only serve to inflate the Company's equity cost estimate. If included in the cost of equity determination, these adders will substantially and unreasonably increase costs for ratepayers.[831] The OCA opposes the inclusion of these adjustments. OCA MB at 74-75.

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825 *Id*. at 4.
826 *Id*. at 34-48.
827 *Id*.
828 OCA St. 3 at 4; Exh. KWO-1
829 OCA St. 3 at 53-87.
830 OCA St. 3 at 3-4, 6-26.
831 *See*, OCA St. 3 at 15, 101-115, 118-125; *see also*, I&E St. 2 at 35-48.

If the Commission were to employ a "business as usual" approach in this proceeding, the OCA submits that the Commission should adopt the OCA's cost of capital recommendations for PECO.[832] The OCA recommends the Company be given the opportunity to earn no more than an 8.75% on a common equity ratio of 50%, resulting in an overall allowed return on rate base of 6.30%.[833] The Commission, however, is not so constrained as to its eventual decision on the return on equity component. OCA asserts that the substantial evidence of record as to the economic and societal effects of the pandemic must be considered in order to arrive at rates that meet the constitutional just and reasonable standard.[834] OCA MB at 75.

When further considering the impacts of the COVID-19 Pandemic to arrive at a fair rate of return, a return on equity lower than a market-derived return on equity may be set that reflects current economic and societal circumstances. As stated in the beginning of this Brief, if the Company were to receive no increase at this time and all of its adjustments and claims to rate base and O&M expense were adopted, the Company would continue to receive a 5.74% overall rate of return. OCA asserts that this would continue to provide the Company an opportunity to earn a fair rate of return while benefiting consumers with public utility service at reasonable rates, consistent with Pennsylvania law and public policy as set forth in the Public Utility Code. OCA MB at 75.

ii. The Legal Framework for Determining What Rate of Return is Fair to PECO Consumers and the Company's Investors

b. Capital Structure

The Company's estimated June 30, 2022 capital structure is comprised of 53.38% common equity and 46.62% long-term debt.[835] The question of what ratio of equity and debt the Commission should approve for setting rates in this proceeding is of vital concern to the Company's ratepayers who will pay the increased rates. At its most basic, Mr. O'Donnell noted that "[r]eturns on common equity, which in part take the form of dividends to stockholders, are

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[832] OCA St. 3 at 3-4, 126-127.
[833] *Id*., KWO Exh. 1.
[834] *Id*. at 27-30.
[835] PECO St. 5-R; Exhibit PRM-1 (Updated).

not tax deductible which, on a pre-tax basis alone, makes this form of financing about 21% or more expensive than debt financing."[836] The utility's capital structure impacts the calculation of total return. "Costs to consumers are greater when the utility finances a higher proportion of its rate base investment with common equity and preferred stock versus long-term debt."[837] Mr. O'Donnell explained further that "if a utility is allowed to use a capital structure for ratemaking purposes that is top-heavy in common stock, customers will be forced to cover the higher income tax burden, which can result in unjust, unreasonable, and unnecessarily high rates."[838] OCA MB at 78-79.

As a matter of sound ratemaking, Mr. O'Donnell emphasized that "[r]ate-regulated utilities should only be allowed to recover in rates a revenue requirement derived from a capitalization ratio that allows the utility to provide reliable service at the least cost."[839] The task of finding the right balance of debt-to-equity ratios is critical.[840] OCA MB at 79.

Mr. Moul stated in his direct testimony that he would adopt the capital ratios provided by the Company:

> Because rate-setting is prospective, the rate of return should, at a minimum, reflect known or reasonably foreseeable changes which will occur during the course of the test year. As a result, I will adopt the Company's FPFTY capital structure ratios of 46.62% long-term debt and 53.38% common equity.[841]

OCA witness O'Donnell found the only substantiating discussion included as a basis for the decision to use the 53.38% common equity ratio is the following:

> The five-year average common equity ratios, based upon permanent capital, were 54.1% for PECO Energy, 52.6% for the Gas Group, and 42.2% for the S&P Public Utilities. The Company's common equity ratio was fairly similar to the Gas Group, thereby indicating similar financial risk.[842]

OCA MB at 79.

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836 OCA St. 3 at 34.
837 *Id*. at 35-36.
838 *Id*. at 36-37.
839 OCA St. 3 at 37.
840 *Id*.
841 PECO St. 5 at 21.
842 PECO St. 5 at 15.

For the purpose of determining an appropriate cost of equity, Mr. Moul has acknowledged that there is a recession, and the COVID-19 Pandemic presents unusual factors which make this case "unique," events which have impacted both the debt and equity capital markets.[843] Yet, Mr. Moul's recommendation on the appropriate equity ratio does not reflect any similar consideration of the appropriateness of the Company's proposed capital structure.[844] OCA MB at 80.

OCA witness O'Donnell is generally skeptical of projected common equity ratios.[845] "Most projections tend to set common equity at too high a value given the inherent subjectivity and erratic nature of where the common equity ratios may actually fall out in the future years."[846] Mr. O'Donnell's concern is "additionally relevant given the economic climate in 2020 where the COVID-19 pandemic has increased the uncertainty associated with projected future common equity ratios."[847] OCA MB at 80.

Mr. O'Donnell disagreed that the Company's proposed capital structure is appropriate for ratemaking purposes in this proceeding.[848] As Mr. O'Donnell testified, "[n]othing in the make-up of PECO Energy – Gas Division suggests that it requires a high equity ratio in the range that they are requesting, which would translate into lower financial risk, than any of the companies within the comparable proxy group."[849] OCA MB at 80.

If the Commission does not adopt the OCA's primary recommendation as set forth by OCA witness Scott Rubin, Mr. O'Donnell has recommended that the Commission employ a capital structure that contains an equity ratio of 50% common equity and 50% long-term debt.[850] This lower level of equity ratio is more appropriate to set just and reasonable rates

843 PECO St. 5 at 2-3.
844 *See* PECO St. 5 at 2-3.
845 OCA St. 3 at 47.
846 *Id.*
847 *Id.*
848 *Id.* at 43.
849 OCA St. 3 at 43.
850 OCA St. 3 at 44, Table 8.

and protect ratepayers from paying "higher rates associated with a capital structure that consists of so much higher cost equity."[851] OCA MB at 80.

Mr. O'Donnell identified the appropriate equity ratio of 50% based upon a review of: a) the common equity ratio of the companies in the OCA proxy group (50.70%) and PECO's parent company Exelon (50.40%), b) the common equity ratio granted by utility regulators across the United States in 2019 (51.75%), and c) the common equity ratio granted by utility regulators across the U.S. over the past 15 years (49.91%).[852] OCA MB at 81.

To set just and reasonable rates in this proceeding, the OCA asserts that the Commission should adopt the OCA recommended capital structure of 50% common equity and 50% long-term debt. OCA MB at 81.

c. Cost of Long-Term Debt

The OCA notes that it has accepted the Company's revised embedded long-term cost of debt of 3.84%. OCA RB at 50.

d. Common Equity Cost Rate

i. Introduction

OCA witness O'Donnell developed a market-based cost of equity recommendation of 8.75% based upon the DCF method, with use of a Capital Asset Pricing Model (CAPM) analysis as a check on the reasonableness of his DCF indicated results.[853] In addition, Mr. O'Donnell conducted two Comparable Earnings (CE) analyses, including a review of state utility commission authorized returns for gas utilities.[854] Mr. O'Donnell's market-based

851 *Id.* at 43.
852 OCA St. 3 at 39-43.
853 OCA St. 3 at 53-54, 78-79, 87-88.
854 *Id.* at 75-78.

cost of equity analyses are based upon data through mid-December 2020.[855] Mr. O'Donnell's recommended 8.75% common equity cost rate is close to the middle of his DCF range and above the range of his CAPM results.[856] OCA MB at 82.

As part of his recommendation, Mr. O'Donnell stressed the importance of recognizing the negative impact of the COVID-19 Pandemic on consumers and the nation, including higher unemployment than in 2019 and business closures.[857] Mr. O'Donnell also pointed out that some current economic conditions are more favorable to utilities.[858] Declines in U.S. Treasury bond yields and Federal Fund rates indicate that the cost of capital has decreased for companies like PECO and are expected to remain low.[859] Indeed, PECO reduced its overall debt cost based on expected lower rates.[860] Also, demand for utility equities has been more steady than the market at large.[861] OCA MB at 82-83.

OCA maintains that, in consideration of these facts, it would be unreasonable to burden PECO ratepayers with higher costs based on the Company's 10.95% return on equity proposal. The OCA also opposes I&E witness Keller's recommended 10.24% cost of equity rate, as not reflective of current market conditions.[862] OCA witness O'Donnell properly applied a DCF analysis checked by the CAPM in this proceeding to arrive at a market-derived cost rate of equity. Thus, the OCA recommended an 8.75% cost of equity for PECO should be adopted by Commission under a 'business as usual' approach based upon the record and informed judgment. OCA MB at 83.

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855 *See e.g.*, OCA St. 3 at 59; OCA St. 3-SR at 34.
856 OCA St. 3 at 88, 90.
857 OCA St. 3 at 14-15, 22-23, 89.
858 *Id.* at 6-26, 89-92; OCA St. 3-SR at 15-19.
859 OCA St. 3 at 7-9; OCA St. 3-SR at 20, 24, 31-32, 42.
860 *Id*. at 15.
861 OCA St. 3 or 9-13.
862 OCA St. 3-R at 2.

ii. OCA Witness O'Donnell's Proxy Group Approach Provides the Commission With Useful Observations From All Ten Companies Followed by Value Line's Gas Utility

To estimate the cost of equity, a proxy group of similar companies is needed. A proxy group is generally preferred over the use of data exclusively from any one company because it has the effect of smoothing out potential anomalies associated with a similar company and is therefore a more reliable measure.[863] In developing his recommendation, OCA witness O'Donnell chose to use the full group of gas utilities compiled and followed by *Value Line*.[864] The number of available gas utilities needed to develop a reasonably reliable comparable group is dwindling.[865] The OCA proxy group includes each of the companies in Mr. Moul's proxy group, with one difference.[866] First, Mr. O'Donnell included UGI Corporation in his proxy group, a company excluded by Mr. Moul from the Company's proxy group.[867] Mr. O'Donnell and Mr. Moul each included Chesapeake Utilities in their respective proxy groups, as a utility followed by the *Value Line's* Natural Gas Utility industry. As Mr. O'Donnell noted, Chesapeake Utilities operates a diverse set of businesses that include natural gas distribution, natural gas transmission, electric distribution operations, propane distribution and other lines of business.[868] UGI Corp. is similar as its diversified business portfolio includes natural gas utility service, as well as propane, international liquid propane gas (LGP), energy service, and electric generation.[869] Mr. O'Donnell has included UGI Corp. in his proxy group, disagreeing with Mr. Moul's decision to include one diversified company (Chesapeake Utilities) while excluding another (UGI Corp.)[870] OCA MB at 83-84.

Mr. O'Donnell separately examined the existing capital structure and cost of equity indicated for PECO Energy's ultimate corporate parent Exelon. Exelon is traded on the New York Stock Exchange and is followed by *Value Line Investment Survey*, classified as an

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863 *Pa. Pub. Util. Comm'n v. UGI Utils., Inc. – Elec. Div.*, Docket No. R-2017-2640058, Order at 82 (Pa. PUC Oct 25, 2018) (*UGI Electric*), *aff'd*, *McCloskey v. Pa. Pub. Util. Comm'n*, 225 A.3d 192 (Pa. Commw. Ct. 2020).

864 OCA St. 3 at 31-33.

865 *Id*. at 31.

866 *Id*.

867 *Id*. at 31-33.

868 *Id*. at 32-33.

869 *Id*.

870 *Id*.

electric utility.[871] Mr. O'Donnell examined Exelon as the company with the most direct link to PECO Energy – Gas Division, tempered by recognition of the different returns and capital need for electric utilities and natural gas utilities.[872] OCA MB at 84.

iii. OCA Witness O'Donnell Has Relied Upon the Discounted Cash Flow Model, The Commission's Preferred Method of Setting Common Equity Cost

Mr. O'Donnell's recommended cost of equity of 8.75% is based upon the range of the DCF results for his proxy group, 7.75% to 10.00%.[873] Mr. O'Donnell favors the DCF model as more reliable and superior to other approaches such as the CAPM, CEA, or Risk Premium model.[874] Mr. O'Donnell noted the broad acceptance and reliance on the DCF method as a widely used method for estimating an investor's required return on a firm's common equity.[875] The DCF model allows analysts and investors to factor in a company's financial fundamentals over the long term.[876] In particular, the DCF model accommodates analysts' focus on earnings, dividend and book value growth.[877] An advantage is that the DCF model is straightforward and easy to understand.[878] "To determine the total rate of return one expects from investing in a particular equity security, the investor adds the dividend yield, which they expect to receive in the future, to the expected growth in dividends over time."[879] OCA MB at 84-85.

OCA asserts that the Commission has long relied upon the DCF method to determine a market-based common equity cost rate. As the Commission noted in *PAWC 2004*:

> Historically, we have primarily relied on the DCF methodology in arriving at our determination of the proper cost of common equity. We have, in many recent decisions, determined the cost of common equity primarily based upon the DCF method and informed judgment. [citations omitted] We determine that the DCF

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871 OCA St. 3 at 6.
872 *Id.* at 39-44, 55-56, 67; OCA St. 3-S at 27.
873 OCA St. 3 at 88.
874 *Id*. at 54-55, 78.
875 *Id*. at 56.
876 *Id.* at 57.
877 *Id.*
878 *Id*. at 58-59.
879 *Id.* at 59.

> method is the preferred method of analysis to determine a market based common equity cost rate.[880]

More recently, the Commission has affirmed its primary reliance on the DCF method to determine a market based common equity cost rate, stating that it has "found no reason to deviate from the use of this method…."[881] OCA MB at 85.

iv. OCA Witness O'Donnell's DCF Analyses Provide a Robust Basis for His Cost of Equity Recommendation

1. Application of the DCF Model

As described by Mr. O'Donnell, "[t]he DCF method is based on the concept that the price which the investor is willing to pay for a stock is the discounted present value (*i.e.*, its present worth) of what the investor expects to receive in the future as a result of purchasing that stock."[882] This return to the investor is in the form of future dividends and price appreciation.[883] However, price appreciation is only realized when the investor sells the stock, and a subsequent purchaser presumably is also focused on dividend growth following his or her purchase of the stock.[884]

In his rebuttal testimony, Mr. O'Donnell provided this concise summary of his application of the DCF model, data sources, and development of an appropriate dividend yield and growth rate:

> I derived my DCF results by first utilizing Forecasted Annualized Dividend Yields based on three separate time periods (*i.e.*, 13-weeks, 4-weeks, and 1-week) provided by *Value Line*, plus the following growth rates for my 10-company comparable proxy group:

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880 *Pa. Pub. Util. Comm'n v. Pa. Am. Water Co.* Docket No. R-00038304, 2004 Pa. PUC LEXIS 708 at *117-118 (Pa. PUC Jan. 29, 2004) (*PAWC 2004*), *aff'd on other grounds, Popowsky v. Pa. Pub. Util. Comm'n*, 868 A.2d 606 (Pa. Commw. Ct. 2004); *accord Pa. Pub. Util. Comm'n v. Aqua Pa., Inc.,* 99 Pa. PUC 204, 233 (2004).

881 *UGI Elec.*at 106; accord, *Pa. Pub. Util. Comm'n v. Valley Energy*, Inc., Docket No. R-2019-3008209, Order at 102, 104 (Pa. PUC Apr. 27, 2020).

882 OCA St. 3 at 56.

883 *Id*.

884 *Id*.

- Historical EPS, DPS, and BPS growth rates over a 10-year period and a 5-year period provided by *Value Line*;

- Forecasted EPS, DPS, and BPS growth rates from *Value Line*;

- Average plowback growth rate (*i.e.*, percent retained to common equity) provided by *Value Line*;

- 3-year projected EPS growth rate provided by the *Center for Financial Research and Analysis("CFRA")*; and

- 3 to 5-year EPS growth rate provided by *Charles Schwab ("Schwab")*.[885]

OCA MB at 87.

2. OCA Witness O'Donnell's Dividend Yield Range is Based on Current Data and Multiple Observations

Mr. O'Donnell calculated the appropriate dividend yield by averaging the dividend yield expected to be paid over the next 12 months for each comparable company, as reported by the *Value Line Investment Survey*.[886] The period covered by the *Value Line* reported data is from September 25, 2020 through December 18, 2020. Mr. O'Donnell examined the 13-week, 4-week, and 1-week dividend yields for his comparable proxy group, in order to study the short-term and long-term movements in dividend yields.[887] Mr. O'Donnell obtained an average dividend yield for the ten-company proxy group for each of the three time periods – 3.7%, 3.5%, and 3.6%, respectively.[888] OCA MB at 87-88.

Mr. O'Donnell developed these dividend yield ranges "by averaging each company's *Value Line* forecasted 12-month dividend yield over the above-stated periods, as well as examining the most recent forecasted 12-month dividend yield reported by *Value Line* for each company."[889] Mr. O'Donnell employed this averaging approach over multiple time periods

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885 OCA St. 3R at 9.
886 OCA St. 3 at 59.
887 *Id*. at 59.
888 *Id*. at 59, Exh. KWO-2.
889 OCA St. 3 at 59-60.

"in order to minimize the possibility of an isolated event skewing the DCF results."[890] OCA MB at 88.

Mr. O'Donnell's dividend yield range of 3.5% to 3.7% provides a sound basis for Mr. O'Donnell's DCF range of 7.75% to 10.00% for his ten-company proxy group.[891] OCA MB at 88.

3. OCA Witness O'Donnell's Growth Rate Range is Soundly Supported

Mr. O'Donnell evaluated publicly available historic and forecasted growth rate information available for his proxy group companies using three methods. Information about historical growth rates and forecasted growth rate are widely available to investors to use in development of their expectations and would be used by prudent investors.[892] Both historical growth rates and forecasted growth rates provide valuable data for what one can expect the ultimate growth rate for an individual stock will be.[893] OCA MB at 88.

Mr. O'Donnell also examined a variety of growth rates. Limiting his growth rate examination to only earnings growth rates would be improper. "Since the DCF formula is dependent on future *dividend* growth, I believe it would be inaccurate to use only earnings growth rates in the DCF."[894] The use of only earnings growth rates would produce unrealistically high return on equity numbers that cannot be sustained indefinitely.[895] Mr. O'Donnell analyzed earnings per share, dividends per share, and book value per share earnings growth rates to provide a robust, systematic analysis of available financial information.[896] OCA MB at 88-89.

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890 *Id*. at 60.
891 *Id*. at 72-74.
892 OCA St. 3 at 63.
893 *Id*.; OCA St. 3-SR at 36-38.
894 OCA St. 3 at 64.
895 *Id*.
896 *Id.* at 64-65; OCA St. 3-SR at 36-38.

First is the plowback ratio method. Under this approach, if a company is earning of a rate of return or "r" on the company's common equity, and it retains a percentage of these earnings or "b", then each year the earnings per share (EPS) are expected to increase by the product (stated as "b x r" or simply "br") of its earnings per share in the previous year. Thus, "br is a good measure of the growth in dividends per share." (DPS). These "br" or plowback ratios are reported by *Value Line* for the proxy group companies under the title "percent retained in common equity."[897] OCA MB at 89.

Second, Mr. O'Donnell addressed development of a growth rate measure that "consider[s] how dividends are created." This leads to the need to analyze "what if any growth can be expected in dividends." Review of book value growth is one part of the inquiry. To analyze the expected growth in dividends, Mr. O'Donnell believes that an analyst should also examine the historical record of past earnings, dividends, and book value. He examined historical EPS, DPS, and BPS growth rates over a 10-year period and a 5-year period provided by *Value Line.*[898] OCA MB at 89.

Third, Mr. O'Donnell evaluated forecasted EPS, BPS, and DPS growth rates. Mr. O'Donnell examined: forecasted compound annual rates of change for earnings per share, dividends per share, and book value per shares as provided by *Value Line*; forecasted 3-year projected rate of change for earnings per share provided by CFRA (a publication of S&P Market Intelligence); and forecasted long-term 3–5-year earnings growth rates compiled by Schwab based on industry analysts' forecasts.[899] OCA MB at 89.

From his analyses and consideration of current gas industry conditions and economic factors, Mr. O'Donnell identified a measure of the growth in dividends that investors would expect.[900] Based upon review of the proxy group's historical EPS, DPS, and BPS growth rates, Mr. O'Donnell identified a proper historical growth rate range to be factored in the DCF

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897 OCA St. 3 at 60-61; OCA St. 3-R at 9.
898 OCA St. 3 at 61-64; OCA St. 3-R at 9.
899 OCA St. 3 at 65; OCA St. 3-R at 9.
900 OCA St. 3 at 60-66.

Model of approximately 3.0% to 5.0%.[901] Mr. O'Donnell reviewed the forecasted growth rate information for the proxy group (including outlier Northwest Natural Gas) and identified a forecasted growth rate range of 5.0% to 7.0% to factor in the DCF Model.[902] OCA MB at 90.

Mr. O'Donnell's final growth rate recommendation is the result of his consideration of the assembled growth rate information and other factors. "[D]ue to the negative growth impact of COVID-19, as well as the fundamental changes that have occurred in the natural gas utility industry over the past ten years," Mr. O'Donnell concluded "it is proper to place more weight on forecasted figures in estimating the cost of equity for the comparable group."[903] Mr. O'Donnell determined that the proper growth rate range for his "DCF analysis is 4.25% to 6.25%."[904] OCA MB at 90.

4. OCA Witness O'Donnell's Final DCF Recommendation

Mr. O'Donnell's 8.75% cost of equity recommendation is based upon his DCF result range of 7.75% to 10.00%.[905] Mr. O'Donnell identified the range based upon a matrix combining his dividend yield measures for three periods and historical and forecasted growth rates based upon his three methods.[906] Mr. O'Donnell's 8.75% cost of equity recommendation is close to the middle of his DCF result range.[907] OCA MB at 90.

The OCA submits that Mr. O'Donnell's DCF analyses provide a sound foundation for his DCF based cost of equity recommendation for PECO of 8.75%. OCA MB at 90.

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901 *Id.* at 68, 71-74; Exh. KWO-2.
902 *Id.* at 69-74.
903 *Id*. at 73.
904 *Id*. at 74; Exh. KWO-5.
905 OCA St. 3 at 74.
906 *Id*., Table 9.
907 *Id*. at 88, 90.

v. OCA Witness O'Donnell's Capital Asset Pricing Model

Mr. O'Donnell performed CAPM analyses to provide the Commission with additional information, based upon market and financial data for the proxy group companies.[908] Mr. O'Donnell identified a range of 5.50% to 7.75% based upon his CAPM results.[909] However, Mr. O'Donnell expressed his reservations regarding the usefulness of the CAPM approach. Specifically that the application of the CAPM in an inaccurate manner, "such as when forecasted risk premiums or forecasted interest rates are employed," can lead to erroneous results.[910] OCA MB at 91.

The CAPM is "a measure of firm-specific risk, known as unsystematic risk and measured by beta, as well as overall market risk, otherwise known as systemic risk and measured by the expected return on the market."[911] The CAPM formula requires identification of the risk-free rate, beta as the risk of the studied company relative to the overall market, and the expected return on the market.[912] OCA MB at 91.

The risk free rate is designated as the yield on United States government bonds as the risk of default is seen as highly unlikely.[913] In his CAPM analyses, Mr. O'Donnell developed risk premiums relative to the 30-year U.S. Treasury bonds, "as this time period is the longest available in the marketplace, thereby affording consumers the longest protection at the risk-free rate."[914] To approximate the risk-free rate, Mr. O'Donnell utilized historical 30-year U.S. Treasury Bond Yields from December 11, 2019 to December 11, 2020.[915] Mr. O'Donnell identified 1.61% as his risk free rate, as the average of his 30-year risk free rate range of 0.99% to 2.39%.[916] Mr. O'Donnell also considered changes in the federal funds rate from late 2019 and in response to the impact of the COVID-19 throughout 2020.[917] Mr. O'Donnell affirmed the

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908 OCA St. 3 at 53, 79.
909 *Id*. 86-88; OCA St. 3-R at 13; OCA St. 3-SR at 41.
910 OCA St. 3 at 79.
911 OCA St. 3 at 80.
912 *Id*. at 79-80.
913 OCA St. 3 at 80.
914 *Id*.
915 OCA St. 3 at 7-9 (Chart 1), 86-87; OCA St. 3-SR at 41.
916 OCA St. 3-R at 14; OCA St. 3-SR at 44.
917 *Id*. at 6-9, 81.

reasonableness of his risk free rate inputs, based on a strategy change by the Federal Reserve likely to keep interest rates at their low levels for a long time.[918] OCA MB at 91-92.

Beta is a statistical calculation of a company's stock price movement relative to the overall stock movement. Betas below 1.0 indicate less volatility in stock price. Betas above 1.0 indicates a company with a stock price that is less volatile than the overall market.[919] As generally conservative equity investments, utility betas are almost always less than 1.0.[920] The average beta for Mr. O'Donnell's proxy group companies is 0.89%.[921] OCA MB at 92.

Mr. O'Donnell developed his current market risk premium from the Ibbotson database published by Morningstar.[922] Mr. O'Donnell provided an overview of the market return forecasts – equity risk premium as well as total market returns – published by Morningstar on April 23, 2020, information which reflects a large range of expectations.[923] Mr. O'Donnell concluded, using historical data as well as ex ante (forecasts) data, "the evidence suggests the equity risk premium is clearly within the range of 4.25% to 6.25%."[924] OCA MB at 92.

Mr. O'Donnell used the *Value Line* derived beta sourced from the most recent *Value Line* editions for each company in the comparable proxy group.[925] Mr. O'Donnell concluded the proper return on equity from the CAPM is in the range of 5.00% to 7.75%.[926] Mr. O'Donnell based his range on consideration of the average CAPM results for his proxy group companies with the use of the 4.25% equity risk premium and the 6.25% equity risk premium.[927] OCA MB at 92.

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918 OCA St. 3-SR at 41-42.
919 OCA St. 3 at 64.
920 *Id.*
921 OCA St. 3-R at 14.
922 OCA St. 3 at 82.
923 *Id.* at 82-85.
924 *Id*. at 85; OCA St. 3-R at 14; OCA St. 3-SR at 41-42, 44.
925 OCA St. 3 at 86.
926 OCA St. 3 at 87-88.
927 OCA St. 3, Exh. KWO-7; OCA St. 3-R at 14; OCA St. 3-SR at 44.

In identifying his final recommendation of an appropriate cost of equity for PECO, Mr. O'Donnell considered this CAPM range (5.50% to 7.75%) as a check on his DCF results range (7.75% to 10.00%).[928] OCA MB at 93.

The OCA submits that Mr. O'Donnell's CAPM results reflect a careful examination of available information from analysts, use of a reasonable risk-free rate, *Value Line* betas, and consideration of changes in the economy in general and current and future expectations for federal fund interest rates, in the context of the COVID-19 Pandemic, and its impact on the economy. OCA MB at 93.

vi. OCA Witness O'Donnell's Comparable Earnings Analysis

Mr. O'Donnell conducted two different Comparable Earnings Analyses (CE).[929] One examined returns on book value equity for the comparable group. The second examined allowed natural gas utility returns over an extended period of time to evaluate trends in returns for companies of similar risk.[930] OCA MB at 93.

First, Mr. O'Donnell compared companies of similar risk to PECO, specifically his proxy group of gas utilities followed by *Value Line*.[931] Mr. O'Donnell examined "historic and forecasted earned returns *on book value equity* of the proxy group over the period of 2018 through 2025E."[932] Based upon this review, the average earned returns on equity for the proxy group companies ranged from 8.9% (2020E) to 10.4% (2018).[933] However, the level of return suggested by this type of analysis is not directly comparable or relatable to a DCF result, where this type of CE focuses on the return on book value and not a return on market value.[934] OCA MB at 93.

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928 OCA St. 3 at 54, 78-79, 87-88.
929 OCA St. 3 at 75-78.
930 *Id.*
931 OCA St. 3 at 57.
932 *Id*. at 75; Exh. KWO-4. (emphasis in original).
933 *Id.*
934 *Id.* at 77-78.

Second, Mr. O'Donnell evaluated the history and trend of what state utility commissions across the country are allowing for authorized returns on equity.[935] Mr. O'Donnell's Chart 6 shows "the ROEs authorized for natural gas utilities by state regulators across the United States from 2005 through 2019."[936] Mr. O'Donnell noted that the average allowed ROE for 2019 was 9.71%.[937] The average allowed ROE for natural gas utilities in 2020 was even lower at 9.46%, with no single rate above 10.00%.[938] Mr. O'Donnell's Chart 6 and Chart 1S provide useful evidence that utility regulators are acknowledging the declining trend in the cost of capital for gas utilities.[939] "Regulators may not move at the pace of the general market in terms of the decline in the market cost of capital, but regulators are, without a doubt, moving in that direction."[940] OCA MB at 93-94.

Mr. O'Donnell did combine some of the observations from these two different CE into a range of returns, 9.25% to 10.25%.[941] However, Mr. O'Donnell cautioned that the CE approach is of limited usefulness and has shortcomings.[942] Significantly, the CE model "does not appropriately capture the economic impacts of the pandemic within the output of the Model."[943] Mr. O'Donnell affirmed that the DCF model produces the most reliable results, with use of the CAPM as a check. OCA MB at 94.

vii. OCA's Return on Equity Recommendation of 8.75% for PECO is Supported and Appropriate to these Current and Future Market Conditions

Mr. O'Donnell concurs with the OCA's primary recommendation of no rate increase, as set forth in Mr. Rubin's testimony as an appropriate result in light of the significant economic consequences of the COVID-19 Pandemic.[944] In the alternative, Mr. O'Donnell has developed a market-based recommended cost of equity of 8.75%, which the Commission should

935 OCA St. 3 at 76-77.
936 *Id.*
937 *Id.* at 77.
938 OCA St. 3-SR at 19-20.
939 OCA St. 3 at 77; OCA St. 3-SR at 19-20.
940 OCA St. 3 at 89.
941 OCA St. 3 at 77-78.
942 *Id.*
943 *Id.* at 78.
944 OCA St. 3 at 3-4; OCA St. 3-SR at 1, 23.

apply to an equity ratio of 50%, to produce an overall return of 6.30% for PECO.[945] The OCA submits that any other higher return would be excessive and unreasonably over-burden PECO ratepayers during these unusual times of economic hardship arising from the COVID-19 Pandemic. OCA MB at 94.

e. Business Risks and Management Performance

i. Business Risks

The OCA submits that the Commission should consider the following financial and economic factors in determining an appropriate cost of capital for PECO and PECO ratepayers. OCA MB at 95.

The debt market for PECO has changed since the last base rate cases for PECO Energy Company (electric and gas).[946] In the 2018 base rate case, PECO Energy Company – Electric Division requested a 10.95% ROE.[947] As shown by Mr. O'Donnell's analysis of the change in the 30-year U.S. Treasury bond yields, long-term interest rates have fallen, most notably in the past year.[948] The yield on the 30-year U.S. Treasury bonds decreased by 60-basis points between December 11, 2019 (2.23% yield) and December 11, 2020 (1.63% yield).[949] The yield on the U.S. Treasury bond closed even lower on January 14, 2021 at 1.88%.[950] OCA MB at 95.

Since September 19, 2019, the Federal Reserve has reduced the Federal Funds target range in a series of steps from a high target of 2.0 identified in September 2019 to a 0.25% target as announced March 15, 2020.[951] Based upon recent Federal Reserve guidance, interest

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945 OCA St. 3 at 3-4.
946 OCA St. 3 a 6-9, 16.
947 *Id.* at 6.
948 *Id.* at 6-7, Chart 1.
949 *Id.*
950 OCA St. 3-SR at 3.
951 OCA St. 3 at 7-9, 16.

rates are predicted to stay unchanged through at least 2023.[952] The decrease in the Federal Funds rate signals a decrease in the cost of capital for companies like PECO.[953] OCA MB at 95.

Accordingly, these changes in the yields on the U.S. Treasury 30-year bonds and significant decreases in the Federal Funds rates have given rise to some turmoil in the markets, leading investors to look for safe harbors. This has contributed to some increased demand for bonds with a resulting decrease in yields.[954] OCA MB at 95.

The equity markets have also changed in recent years. Comparisons of the change in the Dow Jones Utility Average (DJUA) since the last PECO Gas rate case (2010) and since the last PECO Electric rate case (2018) to the DJUA close on January 14, 2021, represents significant increases in the DJUA.[955] As Mr. O'Donnell testified "[s]uch a strong upward movement in the utility equity market is indicative of investors accepting a lower cost of capital on their investments."[956] OCA MB at 96.

Changes in the DJUA compared to the Dow Jones Industrial Average (DJIA) are also informative.[957] As Mr. O'Donnell observed, the difference between the equity prices for utilities versus industrials reflects the importance of utilities as providers of essential services.[958] The market for utility equities since the start of the COVID-19 pandemic has rebounded and steadied.[959] OCA MB at 96.

These are important factors, which should shape the Commission's determination of an appropriate cost of capital for PECO. OCA MB at 96.

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952 OCA St. 3-SR at 42.
953 OCA St. 3 at 9.
954 OCA St. 8-9.
955 OCA St. 3-SR at 3.
956 *Id.*
957 OCA St. 3 at 9-13, Table 3; OCA St. 3-R at 3.
958 *Id.* at 12.
959 OCA St. 3 at 20.

ii. PECO's Requested Return on Equity Addition Based on Management Performance Should be Rejected

OCA witnesses O'Donnell and Colton evaluated the Company's request to increase the allowed return on equity by 25 basis points to reward the Company for the performance of management, past and current. Both Mr. O'Donnell and Mr. Colton determined that the Company's management performance is not sufficient to justify the imposition of additional costs[960] on PECO ratepayers under normal conditions. The fact of the current pandemic and the economic hardships faced by PECO residential and business customers further weighs against a grant of the Company's request.[961] Mr. Colton faults the Company's COVID-19 emergency response plan as non-compliant under Chapter 14 and wholly inadequate to meet the needs of consumers in crisis. The OCA recommends that the Commission deny the Company's request, based upon consideration of the Company's regulatory obligations and the evidentiary record.[962] OCA MB at 96-97.

1. The Company's Request

PECO witness Moul's recommended return on equity includes an additional 25 basis point premium to reflect the performance of the Company's management, variously characterized as exemplary or superior.[963] PECO witness Bradley cited various PECO initiatives to address gas system safety and reliability, customer service changes, employee volunteerism, and other activities spanning the past ten years or so.[964] The Company also cited its improvement in J.D. Power scores, cost savings efforts between rate cases, as well as the Company's recent efforts to implement COVID-19 emergency assistance plans for PECO customers described by PECO witness Colarelli.[965] OCA MB at 97.

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[960] I&E witness Keller calculated the impact of the Company's 25 basis point cost of equity adjustment at over $3.2 million, based upon the Company's original revenue requirement request. I&E St. 2 (Public) at 45.

[961] OCA St. 3 at 22; OCA St. 3-S at 6-7.

[962] OCA St. 3 at 5, 15, 21-22, 118-125; OCA St. 5 at 90-108; OCA St. 3-S at 3-11; OCA St. 5-SR at 2-4, 10-13.

[963] PECO St. 1 at 2, 25; PECO St. 5 at 2, 7.

[964] PECO St. 1 at 2, 14-25.

[965] *Id.*; PECO St. 1-R (public) at 15, 17-18.; PECO St. 10-R (revised) at 3-5; TR. 219 (public), li. 13-19.

The Company offered different explanations of how it arrived at the 25 basis points measure. According to Mr. Moul, that Company's total cost of equity request of 10.95%, inclusive of the 25 basis points, is within the range of the results of his multiple cost of equity analyses.[966] Mr. Moul's discovery reply concluded with the explanation "Mr. Moul's recommended 10.95% (i.e. 10.70% + 0.25%) rate of return on common equity provides recognition for the Company's management effectiveness that includes this 0.25% increment."[967] Company witness Bradley stated that PECO should be allowed an ROE, inclusive of recognition for management performance, "near the upper end of the range" recommended by Mr. Moul.[968] OCA MB at 97-98.

2. Ratemaking Adjustment for Management Performance is a Matter of Commission Discretion

PECO has made its request for the cost of equity increase based upon Section 523.[969] According to Company witness Moul, the Commission has granted a higher return on equity for utilities in the past for management performance and should do so in this proceeding.[970] The OCA disagrees. OCA MB at 98.

Consideration of utility service quality is but one factor in the Commission's determination of just and reasonable rates. Section 523 permits the Commission to consider a request for an adjustment – upwards or downwards – to a component of the utility's cost of service to recognize the efficiency, effectiveness and adequacy of service.[971] In addition to evaluating whether PECO's request is supported, Section 523(a) instructs the Commission to consider "all other relevant evidence of record …."[972] The Commission shall give effect to Section 523 "by making such adjustments to specific components of the utility's claimed cost of service *as it may determine to be proper and appropriate*."[973] OCA MB at 98.

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966 OCA St. 3 at 119-120, quoting OCA-IV-19 reply.
967 *Id.*; OCA St. 3-S at 6.
968 OCA St. 3-S at 6, citing PECO St. 1-R (public) at 18.
969 PECO St. 1 at 25, citing 66 Pa. C.S. § 523.
970 PECO St. 5-R at 29, 30.
971 66 Pa.C.S. § 523(a).
972 *Id*.
973 *Id*. (emphasis added).

First, the current pandemic and economic hardships confronting Pennsylvania utility consumers, including PECO ratepayers, is critical "other relevant information" which the Commission should consider.[974] In *Columbia Gas*, the Commission supported the ALJ's reasoning that the utility's proposal to increase rates to reward management performance would defeat the purpose and benefits of effective operating and maintenance cost measures, which should flow through to ratepayers and/or investors, "particularly during a pandemic when so many ratepayers have experienced reduced household income from job loss or reduction in hours."[975] The Commission adopted the ALJ's recommendation, as "supported by ample record evidence and is just and reasonable."[976] OCA MB at 98-99.

Second, PECO's management performance claim does not satisfy the Commission's standards. As a regulated fixed utility, PECO is required to provide safe, adequate, reasonable, and efficient service as a matter of law.[977] An appropriate rate of return on common equity assumes efficient and reasonable management of a utility.[978] OCA MB at 99.

A utility must be doing much more than providing efficient and reasonable service in order to receive a positive performance adjustment pursuant to Section 523.[979] For example, compliance with quality of service regulations or LTIIP and DSIC regulations[980] may document the provision of adequate, efficient, safe, and reasonable service as required by Section 1501.[981] Such basic regulatory compliance alone does not support a Section 523 adjustment to increase rates.[982] Merely "commendable" service does not rise "to the level of supporting an

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974 OCA St. 3 at 124-125; OCA St. 3-S at 6-7.
975 *Columbia Gas* at 134-135.
976 *Id*. at 135.
977 66 Pa. C.S. § 1501; *see also Pa. Pub. Util. Comm'n v. Columbia Water Co.*, Docket No. R-2013-2360798, Order at 50 (Pa. PUC Jan. 1, 2014) (*CWC 2013*).
978 *CWC 2013*, at 50-51.
979 66 Pa. C.S. § 523.
980 To be eligible to have a Distribution System Improvement Charge (DSIC), the utility must have a Commission-approved Long Term Infrastructure Improvement Plan (LTIIP). 52 Pa. Code §§ 121.1, *et seq.* The utility's LTIIP plan for accelerated replacement of infrastructure "must … be sufficient to ensure and maintain adequate, efficient, safe, reliable and reasonable service to customers." 52 Pa. Code. § 121.1. The LTIIP is a tool to ensure the provision of service sufficient to meet the Section 1501 standard.
981 66 Pa. C.S. § 1501.
982 *CWC 2008*, 2009 Pa. PUC LEXIS 1423 at *131-35 (Compliance with safe drinking water standards did not support adjustment); *accord*, *CWC 2013* at 46, 51; *but see UGI Electric*, at 114-15. (Utility consistently exceeded multiple benchmark service reliability metrics).

added premium to its rate of return on common equity."[983] "[A] utility must be doing *significantly more* than providing efficient and reasonable service to justify the receipt of a performance premium."[984] OCA MB at 99-100.

The OCA maintains that PECO's claims of superior management performance do not justify an award of any additional basis points in equity return, as discussed further below. As in *Columbia Gas*, the Commission should deny PECO's requested 25 additional basis points in equity return in setting just and reasonable rates in this proceeding. OCA MB at 100.

f. Other Parties' Equity Cost Rate Recommendations and Principle Areas of Dispute

i. Overview

PECO recommends a 10.95% cost of common equity rate, inclusive of a 25-basis point increment to recognize management performance.[985] Mr. Moul's 10.70% equity return (minus the performance adder) is based, in part, upon application of three analyses – a DCF, CAPM, and Risk Premium (RP) – to a selected group of companies. Additionally, Mr. Moul conducted a Comparable Earnings (CE) analysis, applied to PECO and an assortment of non-utility companies. OCA MB at 111.

I&E witness Keller recommends a 10.24% cost of common equity, as the result of his DCF analysis of a proxy group of gas utilities.[986] Mr. Keller also conducted a CAPM analysis of his proxy group companies and considered the CAPM results for comparison to his DCF results.[987] OCA MB at 111.

The OCA is opposed to both the Company's 10.95% cost of equity recommendation (inclusive of the management adder) and I&E's DCF-based 10.24% cost of

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983 *CWC 2013* at 50.
984 *Id.* at 51 (emphasis added).
985 PECO St. 5 at 2.
986 I&E St. 2 at 6-10, 20-23.
987 I&E St. 2 at 24-28.

equity. Both of these measures are overstated. Importantly, neither cost of equity recommendation is appropriate to set rates that assure adequate service to the public at the least cost.[988] Grant of an excessive rate of return would burden consumers and provide a windfall to current investors, further leading to rates that are unjust and unreasonable.[989] The Company's 10.95% and I&E's 10.24% cost of equity recommendations are especially overstated in consideration of the current pandemic and financial hardships confronting consumers.[990] OCA MB at 111-112.

The OCA's points of disagreement include the Company's proxy group, Mr. Moul's inclusion of adjustments in his DCF analysis to develop his dividend yield, his growth rate, and addition of a leverage adjustment.[991] Mr. Moul's application of the CAPM is also flawed and overstated as he included adjustments for size and leverage. The OCA also disagrees with the Company's reliance on Risk Premium (RP) analysis results and a CE applied to non-regulated companies.[992] OCA MB at 112.

The OCA's criticisms of I&E's approach are fewer but equally significant, including I&E's small proxy group, Mr. Keller's development of a growth rate for his DCF, and Mr. Keller's choice of inputs in his CAPM which result in a high measure of 9.08%.[993] OCA MB at 112.

ii. The Company's Cost of Equity Recommendation is Excessive

The Company has identified several possible cost of equity numbers, which PECO might accept for setting rates in this this proceeding. First, there is the Company's cost of equity claim of 10.95%, inclusive of 25-basis points for management performance, as based upon Mr. Moul's multiple analyses.[994] Mr. Moul based this 10.95% cost of equity

988 *Penn Power 1982*, 1982 Pa. PUC LEXIS 154 at *65-69.
989 OCA St. 3 at 28.
990 OCA St. 3 at 12, 17, 22-23; *see*, OCA St. 3-S at 22.
991 OCA St. 3 at 3-4, 95-103; OCA St. 3-S at 2-4; 31-40.
992 OCA St. 3 at 116-118.
993 OCA St. 3-R at 5-15.
994 PECO St. 5 at 2.

recommendation on the range of results for his DCF (12.74%), CAPM (12.33%) and RP (10.25%) analyses of his proxy group in his direct testimony.[995] Mr. Moul stated that his selection reflects consideration of the current, but temporary impact of the COVID-19 pandemic.[996] OCA MB at 112-113.

In rebuttal, Mr. Moul continued to support the Company's 10.95% cost of equity recommendation.[997] Mr. Moul updated his cost of equity analyses in rebuttal, identifying an increase in the "simple dividend yield plus growth return from 10.78% originally to 11.29%," a 0.51% increase (before his DCF leverage adjustments).[998] Based upon updates to each of his models (inclusive of adjustments), Mr. Moul concluded that the average of those new results "show a net decrease in the cost of equity of two basis points."[999] Mr. Moul continued to support the Company's recommended 10.95% cost of equity, inclusive of the management performance increment.[1000] OCA MB at 113.

However, Mr. Moul also testified in rebuttal that a cost of equity of 10.49%, based upon the I&E recommended 10.24% plus the Company's requested 25-basis points for management performance "would be close to adequate."[1001] Further, Mr. Moul proposed that the 10.15% or 10.20% return on equity for gas utilities included in recent Commission Quarterly Earnings Reports should be the floor for the authorized cost of equity in this proceeding.[1002] OCA MB at 113.

The OCA disagrees with the Company's position that a) a 10.95% cost of equity would be reasonable, b) that a 10.49% return could be adequate, and c) the authorized cost of equity should be no lower than the return on equity for gas utilities of 10.15% or 10.20% reported by the Commission in recent Quarterly Earnings reports. The OCA emphasizes that the Company bears the burden of proof on this important element of setting just and reasonable

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995 *Id*. at 7-8.
996 *Id.*
997 PECO St. 5-R at 12.
998 PECO St. 3-R at 11-12.
999 *Id.* at 12.
1000 *Id.*
1001 PECO Gas St. 5-R at 12.
1002 *Id*. at 13-14.

rates. The Company has not met this burden with substantial evidence supporting any of the three cost of equity outcomes considered by the Company. OCA MB at 113.

1. The Company's Proxy Group is Not Appropriate

As previously noted by the OCA, OCA witness O'Donnell and Company witness Moul disagree on the inclusion of UGI Corp. in an appropriate proxy group.[1003] Mr. Moul used the publicly traded gas utilities included in *Value Line's* Natural Gas Group as a starting point, but Mr. Moul then excluded UGI Corp. while keeping Chesapeake Utilities as part of the Company proxy group.[1004] Both UGI Corp. and Chesapeake Utilities are diversified corporations and included by *Value Line* in its Natural Gas Utility Industry classification.[1005] OCA witness O'Donnell chose to include all 10 *Value Line* gas utilities in his proxy group, as providing a broader based for development of a cost of equity estimate for PECO and to avoid data integrity issues associated with smaller proxy groups.[1006] OCA MB at 114.

2. PECO Witness Moul's Application of the DCF Method is Flawed

The OCA argues that the results of the Company's DCF model do not provide a sound basis for a determination of an appropriate cost of equity in this proceeding. First, the Company's application of the DCF model includes unnecessary and unsupported adjustments to the dividend yield and for leverage, as explained by OCA witness O'Donnell.[1007] Second, Mr. Moul averaged the results of his DCF model with the results of his other three analyses, contrary to the Commission's preferred primary reliance on the results of a proper DCF analysis, as discussed above.[1008] OCA MB at 114.

1003 OCA St. 3 at 31-33.
1004 *Id.*
1005 *Id.* at 33.
1006 OCA St. 3-R at 7-8.
1007 OCA St. 3 at 2-3; 95-103; OCA St. 3-SR at 2-3, 30-40.
1008 *See* PECO St. 5 at 7-8; PECO St. 5-R at 12.

3. PECO Witness Moul's Risk Premium and CAPM Analyses are Flawed and Not Appropriate to Determine the Cost of Equity for PECO

Mr. Moul applied a risk premium approach and a CAPM analysis to develop his cost of equity recommendation for PECO.[1009] Based upon his Risk Premium approach, Mr. Moul determined a Gas Group cost of equity of 10.25%.[1010] Mr. Moul's CAPM analysis used a "1.75% risk-free rate of return, the leverage adjusted beta of 1.05 for the Gas Group, the 9.10% market premium, and the 1.02% size adjustment," for a resulting 12.35% cost of equity.[1011] OCA MB at 118.

In rebuttal, Mr. Moul stated that his re-calculated Risk Premium approach "shows a downward move in the cost of equity…."[1012] Mr. Moul revised his CAPM in rebuttal as well, showing a result of 12.76%, an increase from his direct testimony of 34 basis points.[1013] Mr. Moul referenced an increase in the beta (measure of systemic risk) and an increase in risk-free rate.[1014] According to Mr. Moul, "[t]hese increases have been offset by the decline in the market premium."[1015] OCA MB at 118.

The OCA submits that the Commission should not accord any weight to the results of Mr. Moul's Risk Premium analysis or CAPM. First, the Commission has a long-stated policy of relying primarily on the DCF method to estimate the appropriate cost of equity, with consideration of the results of a CAPM for comparison.[1016] In *UGI Electric*, the Commission rejected the utility's Risk Premium analysis because the model depends on indirect observations, where, in contrast the DCF model "measures equity more directly through the stock information, using equity information."[1017] OCA MB at 118-119.

1009 PECO St. 5 at 38-48.
1010 *Id.* at 41.
1011 *Id.* at 40.
1012 PECO St. 5-S at 10.
1013 PECO St. 5-S at 10; OCA St. 3-SR at 31.
1014 *Id.*
1015 *Id.*
1016 *See e.g. UGI Electric*, at 106 ("[T]he use of the DCF model has historically been our preferred methodology.")
1017 *Id.* at 105; *see also Pa. Pub. Util. Comm'n v. Valley Energy, Inc.,* Docket No. R-2019-3008209, Order at 103 (Pa. PUC 2020) (*Valley Energy*) (No weight given to utility's RP method results).

Second, Mr. Moul's Risk Premium and CAPM analyses are flawed by Mr. Moul's choice of inputs and application. OCA St. 3 at 103-116. Mr. Moul's CAPM is further overstated by the inclusion of a leverage adjustment to his beta and a size adjustment.[1018] Mr. Moul's recalculation of these analyses in rebuttal to reflect more current data does not improve the reliability of the results, where based upon the same flawed concepts, inputs, and adjustments.[1019] OCA MB at 119.

Mr. O'Donnell noted that the Risk Premium and CAPM are both essentially risk premium models, where the CAPM is more company-specific due to its use of beta to measure systemic risk.[1020] Both models compare market returns (either total market or utility markets) to bond yields.[1021] OCA MB at 119.

4. PECO Witness Moul's Comparable Earnings Analysis

Mr. Moul presented a CE analysis or approach to provide a comparison between returns realized by non-regulated companies to returns that a public utility with similar risk characteristics would need to realize.[1022] Mr. Moul selected a proxy group of companies based upon risk factors from *Value Line* sources and examined historical realized and forecasted returns for these companies.[1023] Mr. Moul averaged certain of these data points to determine a CE result of 12.90%.[1024] In rebuttal, Mr. Moul reported that his updated CE approach "shows a decline in results."[1025] OCA MB at 121.

The Company's CE results, whether from direct testimony or rebuttal, do not provide information about the appropriate cost of equity for PECO.[1026] Even if they passed certain screens applied by Mr. Moul, the Company's proxy group of non-regulated firms such as

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1018 *Id*. at 105-108.
1019 OCA St. 3S at 31.
1020 OCA St. 3 at 16.
1021 *Id.*
1022 PECO St. 5 at 48-51.
1023 *Id*. at 50-51.
1024 *Id.* at 51.
1025 PECO St. 5-S at 11.
1026 OCA St. 3 at 117-118.

of The Dollar Tree and Scholastic Corporation are simply not comparable to PECO as a regulated gas utility.[1027] Mr. O'Donnell further objected to Mr. Moul's CE as bringing a comparison of book value with market value into the question of determining the appropriate cost of equity for PECO.[1028] OCA MB at 122.

The Commission has rejected a similar CE approach in *UGI Electric* for reasons similar to those identified by OCA.[1029] The utility's identification of the non-regulated firms to analyze as comparable was entirely subjective; the resulting proxy group companies were still very different from a utility company; and the utility's CE focused on returns on book value, not the cost of equity.[1030] Mr. Moul's CE analysis and results should be rejected by the Commission. OCA MB at 122.

5. The Gas Utility Industry Return on Equity Developed for DSIC Purposes Should Not Be Adopted as a Floor in this Proceeding

Mr. Moul proposed that the Commission adopt 10.15% or 10.20% as the minimum cost of equity to establish PECO's revenue requirement in this base rate proceeding.[1031] According to Mr. Moul, the Commission "recently set the equity return for the DSIC in the Quarterly Earnings Report…" addressed at the Commission's January 14, 2021 Public Meeting.[1032] Mr. Moul testified that it "just makes no sense that the cost of equity in a rate case could be any lower than the DSIC return."[1033] Mr. Moul perceived application of a lower cost of equity in setting base rates as a penalty relative to the equity cost rate applied to recovery of plant through the DSIC.[1034] Mr. Moul also perceived a difference in risk between a surcharge subject to true-up and a base rates.[1035] OCA MB at 122-123.

1027 *Id.* at 117.
1028 OCA St. 3 at 118.
1029 *Id.* at 105-106.
1030 *Id.* at 106.
1031 PECO St. 5-R at 13.
1032 *Id.*
1033 *Id.*
1034 *Id.* at 13-14.
1035 *Id.*

The OCA argues that the Commission should reject the Company's proposal to import into this proceeding a cost of equity return calculated outside of this record and for different purposes than the establishment of just and reasonable base rates pursuant to Sections 1301 and 1308(d).[1036] As Mr. O'Donnell explained, the DSIC mechanism provides PECO the opportunity to recover certain eligible investments in gas distribution system replacements between base rate cases.[1037] As an automatic rate recovery mechanism for PECO, the DSIC "lowers its risk."[1038] Contrary to Mr. Moul's inference, not all DSIC eligible plant may be recovered through the DSIC surcharge due to the 5% cap.[1039] The DSIC surcharge reflects specific statutory and regulatory policy, which favors investment in main replacement, subject to consumer protections.[1040] Accordingly, the equity return "that is calculated in some way by Commission staff, for use in a single quarter test of whether PECO is over-earning though its DSIC surcharge, is not suited to identification of the cost of common equity which PECO should be allowed the opportunity to earn as of the end of the FPFTY."[1041] OCA MB at 123.

The OCA asserts that the Commission should reject the Company's position that a return on equity calculated for DSIC purposes should control as a floor in the determination of just and reasonable rates in this base rate proceeding.[1042] OCA MB at 123.

iii. The 10.24% Return on Equity Presented by I&E Witness Christopher Keller is Overstated and Not Suited to These Unusual Times

I&E witness Keller recommended that the Company be allowed a return of equity of 10.24%, based upon the Company's proposed capital structure and cost of debt of 3.84%, for an overall cost of capital of 7.26%.[1043] OCA witness O'Donnell reviewed Mr. Keller's recommendation and determined that I&E's proposed 10.24% return on equity is not reflective

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1036 OCA St. 3-SR at 26-27.

1037 *Id.* at 25.

1038 *Id.*

1039 *Id.* at 25-26.

1040 *Id*. at 26.

1041 *Id*.

1042 In *Columbia Gas*, the Commission authorized a 9.86% cost of equity based primarily upon the DCF method and "the record developed in this proceeding." The Commission did not accept or comment on the utility's position that the 10.15% cost of equity reported by the Commission for DSIC purposes should serve as a benchmark. *See Columbia Gas* at 138-139 (Columbia Exc. # 17), 141 (Disposition).

1043 I&E St. 2-SR at 37.

of current market conditions and could allow PECO to over-earn at the expense of consumers, if adopted by the Commission.[1044] OCA MB at 124.

The I&E recommended cost of equity of 10.24% is the exact value result of Mr. Keller's DCF analysis applied to the I&E seven company proxy group.[1045] Mr. O'Donnell disagreed that I&E's approach identified an appropriate cost of equity for PECO, based upon the narrow data points and factors considered by I&E witness Keller.[1046] OCA MB at 124.

1. The I&E Proxy Group is Too Small

Mr. O'Donnell disagreed with I&E witness Keller's selection of gas utilities to include in the I&E proxy group. Through use of a screen tied to the level of company revenues from gas utility service, Mr. Keller narrowed his proxy group down to just seven of the ten gas utility companies followed by *Value Line*.[1047] In Mr. O'Donnell's opinion, the removal of gas utilities in this way is still subjective. Additionally, by reducing the number of companies in the proxy group, there can be data integrity problems.[1048] The OCA acknowledges that the Commission adopted I&E witness Keller's similar proxy group in *Columbia Gas*, based upon the recommendation of the presiding ALJ.[1049] Nonetheless, the OCA submits that the Commission should determine what proxy group and base of financial information provides the best basis to determine an appropriate cost of equity for PECO based upon this record and current information. OCA MB at 124.

1044 OCA St. 3R at 2.
1045 OCA St. 3-R at 5; see I&E St. 2 at 23.
1046 OCA St. 3-R at 5-7.
1047 OCA St. 3R at 5-8.
1048 *Id.* at 7.
1049 *Columbia Gas* at 110. The OCA notes that the proxy group of ten gas utilities in this proceeding is not the same as the OCA nine-company proxy group examined in Columbia Gas, due to NiSource. *See Id.* at 111.

2. The I&E DCF Analysis

OCA witness O'Donnell notes that the OCA and I&E applied different methods to identify an appropriate dividend yield. Mr. O'Donnell did not oppose Mr. Keller's approach, only the small company base in Mr. Keller's determination.[1050] OCA MB at 125.

The primary difference between the OCA and I&E DCF approach centers around the growth rate.[1051] Mr. O'Donnell criticized I&E's singular reliance on EPS growth rate forecasts.[1052] As Mr. O'Donnell explained, forecasted earnings growth rates may tend to be overly optimistic as earnings growth is difficult to forecast.[1053] Thus, Mr. O'Donnell examined more types of growth rates, historic and forecasted, to moderate or temper the likely overly optimistic bias reflected in EPS forecasted growth rates.[1054] The I&E growth rate approach lacks this balance.[1055] OCA MB at 125.

The I&E growth rate determination is also compromised by Mr. Keller's removal of the forecasted EPS growth rate for one of the seven I&E proxy group companies, Northwest Natural Gas.[1056] Mr. O'Donnell emphasized that this subjective decision by I&E witness Keller is unnecessary, when both historic and forecasted growth rates applied to a larger proxy group as applied by Mr. O'Donnell.[1057] OCA MB at 125.

3. The I&E CAPM Analysis

The CAPM analysis performed by I&E witness Keller is flawed and so the result of a 9.08% cost of equity does not provide a meaningful check on the reasonableness of a proper DCF analysis to identify a market-based cost of equity estimate in this proceeding.[1058] By

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1050 OCA St. 3-R at 10.
1051 OCA St. 3-R at 10.
1052 *Id.*
1053 *Id.*; see, OCA St. 3 at 99-100.
1054 OCA St. 3-R at 10-12.
1055 *Id.*
1056 OCA St. 3-R at 12-13.
1057 *Id*. at 13.
1058 OCA St. 3-R at 15.

comparison, I&E witness Keller's CAPM result of 9.08% exceeded Mr. O'Donnell's identification of a CAPM range of 5.50% to 7.75%.[1059] Mr. O'Donnell identified differences between the time period for Betas sourced by Mr. O'Donnell (current quarter Betas) versus Mr. Keller's use of the average Beta from different time periods for his seven-company proxy group. The resulting OCA Beta was 0.89% compared to Mr. Keller's 0.85%. OCA MB at 125-126.

Mr. O'Donnell and Mr. Keller differed on the appropriate risk-free rate, based upon differences in U.S. Treasury bond yields and whether to use historic or forecasted.[1060] Mr. O'Donnell's use of historic 30-year U.S. Treasury bond yields and resulting risk-free average rate of 1.61% for use in the CAPM provided a better result, than the I&E risk-free rate of 1.23%.[1061] OCA MB at 126.

Mr. O'Donnell testified that Mr. Keller's CAPM results were greatly influenced by Mr. Keller's estimated overall market return of 10.46%, which lead Mr. Keller to use a 9.23% market premium.[1062] That market premium is much higher than the 4.25% to 6.25% market premium range identified by Mr. O'Donnell.[1063] Mr. O'Donnell did not find "the use of the 10.46% overall market return to be realistic given the current economic situation, or even when examining the market trends prior to the impacts of the COVID-19 pandemic."[1064] Additionally, this double digit overall market return of 10.46% employed by I&E witness Keller also exceeded the forecasted market earnings of various market experts, as identified in Mr. O'Donnell's direct testimony.[1065] OCA MB at 126.

The OCA recommends that the Commission not rely upon the results of I&E witness Keller to evaluate the reasonableness of a market-based cost of equity estimate in this proceeding. OCA MB at 126.

1059 *Id*. at 13.
1060 OCA St. 3-R at 14.
1061 *Id*.
1062 OCA St. 3-R at 15.
1063 *Id*.
1064 *Id*.
1065 *Id*.

4. OSBA's Position

a. Introduction

The OSBA notes that at the time it filed its main brief, the yield on the U.S. 10-Year Treasury Bond was 1.44%.[1066] In this proceeding, the Company is requesting an ROE of 10.95%. That is 951 basis points above the 10 Year T-Bond. The OSBA asserts that is an unreasonable risk premium for a public utility such as PECO. OSBA MB at 4.

In addition, PECO requested an upward adjustment to its ROE of 25 basis points based upon exemplary management performance.[1067] The OSBA respectfully submits that a management adder is inappropriate during the COVID-19 Pandemic. As the Commission explained in approving the ALJ's recommended decision and rejecting the proposed management adder in the recently concluded *Columbia Gas* base rates proceeding:

> The ALJ stated that she agreed with I&E, the OCA, and the OSBA that Columbia failed to provide sufficient evidence to support its proposal for an additional twenty-basis points for 'strong management performance.' The ALJ reasoned that while effective operating and maintenance cost measures should flow through to ratepayers and/or investors, Columbia's proposal defeats the purpose of cutting expenses to benefit ratepayers, particularly during a pandemic when so many ratepayers have experienced reduced household income from job loss or reduction in hours. Therefore, the ALJ recommended that no upward management effectiveness adjustment be made to the Company's cost of equity.
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> As noted above, no Party filed Exceptions objecting to the ALJ's recommendation on this issue. We find that the ALJ's recommendation is supported by ample record evidence and is just and reasonable. Accordingly, we shall adopt it without further comment.

Columbia Order, at 134-135. OSBA MB at 4-5.

1066 *See* https://www.bloomberg.com/markets/rates-bonds/government-bonds/us.
1067 PECO Statement No. 5, at 2.

The OSBA recommends that PECO be awarded an ROE of no more than the 8.75 percent recommendation of OCA witness Kevin W. O'Donnell, CFA. OSBA MB at 5.

b. Capital Structure

The OSBA did not brief this specific issue.

c. Cost of Long-Term Debt

The OSBA did not brief this specific issue.

d. Common Equity Cost Rate

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

> The Company requests a 10.95 percent return on equity capital, an equity share of invested capital of 53.4 percent, and an overall average return of 7.70 percent. This is, of course, outrageous. With current 10-year Treasury Bond yields of 0.90 percent, the Company is asking for an equity risk premium of over 1000 basis points.
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> * * *
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> Duff & Phelps (the successor to the respected Ibbotson Associates and Morningstar entities for tracking cost of capital data) recently lowered its average risk cost of equity capital to 8.0 percent, consisting of a risk-free rate of 2.5 percent and an equity risk premium of 5.5 percent. Since regulated natural gas utilities mostly serve customers who have no credible competitive alternatives and are allowed to pass on costs where they face the highest risk, their relative risk should imply a cost of equity capital well below 8.0 percent.[1068]

OSBA MB at 5.

[1068] OSBA Statement No. 1, at 7-8 (footnote omitted).

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

> The Commission should increase its reliance on risk premium methods (including the capital asset pricing model) that reflect long-term historical norms adjusted for the reduced utility risk and reduce its reliance on the DCF method.[1069]

OSBA MB at 6.

The OSBA recommends that the DCALJ and Commission award PECO an ROE significantly below the Company's requested 10.95%. I&E witness Christopher Keller recommended an award of 10.24%, with no change to the Company's proposed capital structure.[1070] OCA witness O'Donnell recommended an award of 8.75%, and Mr. O'Donnell also recommended that the Company's share of equity capital in its capital structure be reduced to 50 percent.[1071] OSBA MB at 6.

The OSBA maintains that all of these proposals imply a risk premium for utility equity that far exceeds the historical risk premium awarded to utilities in the United States. The inability of utility regulators across the country to reasonably regulate the steady increases in equity risk premiums cannot, of course, be resolved by the Pennsylvania Public Utility Commission. The OSBA argues that the Commission can avoid making the problem worse. Accordingly, The OSBA respectfully submits that, while excessive by historical standards, the OCA recommended return on equity award is the only credible proposal in today's economic environment. OSBA MB at 6-7.

e. Business Risks and Management Performance

The OSBA recommends that PECO receive no upward adjustment in its awarded ROE for its management's performance. OSBA MB at 7.

1069 OSBA Statement No. 1, at 13.
1070 I&E Statement No. 2, at 6.
1071 OCA Statement No. 3, at 4.

f. Other Parties' Equity Cost Rate Recommendations and Principle Areas of Dispute

The OSBA did not brief this issue.

5. CAUSE-PA's Position

CAUSE-PA did not brief the rate of return issues.

6. PAIEUG's Position

PAIEUG did not brief the rate of return issues.

7. ALJ's Recommendation on Rate of Return

a. **Capital Structure**

PECO proposes a 7.64% overall rate of return, including a 10.95% return on common equity with the following proposed capital structure: 53.38% common equity, 46.62% long-term debt. The Company's 10.95% return on common equity includes a 25-basis point premium for management performance.

The OCA is the only party to oppose the Company's proposed capital structure, as I&E accepted the Company's proposed capital structure and the remaining parties were silent on the Company's proposed capital structure. The parties, particularly the Company, I&E, the OCA, and the OSBA, provided lengthy arguments about Capital Structure, Cost of Long-Term Debt, Common Equity Cost Rate, and Business Risks and Management Performance. Rather than go on at length, the persuasive arguments provided by the parties are included herein.

On Capital Structure ratios, I recommend that the Commission accept the Capital Structure proposed by the Company. The Company demonstrated that 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. I&E's argument in support of the Company's capital structure, that the Company's claimed capital structure falls within the range of the I&E proxy group's 2019 capital structures, which I&E indicated is the most recent information available at the time of its analysis, was particularly persuasive.

The OCA challenged PECO's proposed capital structure and proposed that the Commission should adopt the OCA's recommended hypothetical capital structure of 50% common equity and 50% long-term debt, arguing that its approach will lead to setting just and reasonable rates. The OCA disagreed that the Company's position that its estimated end of the FPFTY capital structure is supported and reasonable. However, and as noted by the Company, the Commission has determined in previous base rate cases that the legal standard in Pennsylvania for deciding whether to use a party's proposed hypothetical capital structure in setting rates is that if a utility's capital structure is within the range of a similarly situated barometer group of companies, rates are set based on the utility's actual capital structure. The Commission's policy was explained in the *PPL 2012 Order*:

> 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.[1072]

This policy was recently affirmed in *Columbia Gas*.

As noted by PECO, PECO's capital structure falls within the ranges of the common equity ratios in the comparison groups of OCA witness O'Donnell:

[1072] *PPL 2012*, p. 68 (citations omitted).

Table 6: Proxy Group Equity Ratio[1073]

Company	2019 Ratio
Atmos	62.00%
Chesapeake	56.10%
New Jersey Res	50.20%
NiSource Inc.	36.90%
NWNG	51.80%
OneGas	62.30%
South Jersey	40.80%
Southwest Gas	52.10%
Spire	55.00%
UGI Corp.	39.80%
Average	**50.70%**
Exelon Corp	50.40%

and I&E witness Keller, who testified that his proxy group's 2019 capital structures range consists of long-term debt ratios ranging from 33.18% to 53.48% and equity ratios ranging from 32.78% to 59.01%, with a five-year average of 40.29% for long-term debt and 47.60% for common equity (I&E Exhibit No. 2, Schedule 2).

Based on the foregoing, I find that PECO's proposed actual structure is not atypical and is within a range of reasonableness. Accordingly, I recommend that the Commission adopt the Company's proposed capital structure of 53.38% common equity and 46.62% long-term debt.

b. **Cost of Long-Term Debt**

No party disagrees with PECO's proposal to use its actual cost of long-term debt of 3.84%. As there is no disagreement on this issue, I recommend that the Company's proposal be adopted.

[1073] *The Value Line Investment Survey*, November 13, 2020 (Electric Utilities East) and November 27, 2020 (Natural Gas).

c. **Common Equity Cost Rate**

Several of the parties provided lengthy arguments in support of their positions on the Common Equity Cost Rate. PECO maintained that to determine the fair common equity cost rate for the Company, a barometer group of companies must first be determined based on their comparable risk to the Company. PECO and OCA's proxy groups had nine companies in common, with the OCA adding a tenth company, UGI Corp. PECO noted that the nine companies in common between the two proxy groups are made up of the barometer group used in the Bureau of Technical Utility Services' cost of equity models in the Quarterly Earnings Report at Docket No. M-2020-3010940 that was recently approved by the Commission. [1074]

Once the barometer group was determined, the Company calculated the indicated cost of equity using four separate cost of equity models: The DCF methodology, the Risk Premium approach, the CAPM, and the Comparable Earnings method. Following this comparison, the Company determined that, due to the COVID-19 Pandemic, the cost of equity should be near the lower end of the range shown by the market-based models, or at 10.70%.

I&E disputed the Company's proxy group because PECO's proxy group included two companies that I&E did not use – New Jersey Resources Corp. and Southwest Gas Holdings, Inc. I&E did not include these two companies because the two companies did not meet I&E's criterion that fifty percent or more of the company's revenues must be generated from the regulated gas utility industry.[1075] I&E explained the importance of this criterion, noting that revenues represent the percentage of cash flow a company receives from each business line related to providing a good or service.[1076] I&E further explained that if less than fifty percent of revenues come from the regulated gas sector, the companies are not comparable to the subject utility as they do not provide a similar level of regulated business.[1077] The Company proposed an alternative of using the percentage of gas assets to total assets instead of I&E's approach.

1074 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).

1075 I&E Statement No. 2 at 10.

1076 *Id*.

1077 *Id*.

I&E, however, responded that calculating the percentage of utility assets that make up the total assets of a company is not always a reliable way of determining if a business is primarily a regulated utility, and there are differences between businesses in the amount of capital needed.[1078]

Based on the reasoning provided by I&E, I find that the Commission should use I&E's proxy group as it is most comparable to the Company in developing an appropriate cost of equity. Accordingly, I agree with I&E's proposal to calculate the recommended cost of equity pursuant to the Discounted Cash Flow methodology while using the Capital Asset Pricing Model as an alternative means to verify the reasonableness of the return. I recommend that the Commission approve the use of the DCF method as the primary method of determining the cost of common equity and to use the results of the CAPM as a comparison to the DCF results.[1079] It is important to note that recently accepted this proposed methodology in *Columbia Gas*:

> We shall adopt the position of I&E and shall base our determination of the appropriate cost of equity on the results of the DCF method and shall use the CAPM results as a comparison thereto. As I&E noted, the use of the DCF model has historically been our preferred methodology and was recently affirmed in *UGI Electric*. Like the ALJ, we find no reason to deviate from the use of this method in the instant case.[1080]

Accordingly, I recommend that the Commission adopt the 10.24% cost of equity as determined by I&E.

d. **Business Risks and Management Performance**

PECO maintained that the evidence it presented showed 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

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1078 I&E Statement No. 2-SR at 5-6.
1079 I&E Statement No. 2 at 15.
1080 *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa. Inc.,* Docket No. R-2020-3018835 at 131(Order Entered February 19, 2021).

the safety of its workers, and its strong promotion of community and economic development.[1081] 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).[1082] On these grounds, an adder of 0.25% for strong management performance is appropriate.[1083]

I agree with I&E, the OCA and the OSBA that PECO should not be awarded 25 basis points for superior management performance. I am particularly persuaded by I&E's argument that awarding the Company management effectiveness points would cost the customer money for the Company to provide the adequate, efficient, safe, and reasonable service that is required by the Public Utility Code and Commission regulations.[1084] Further, even a modest increase in the cost of equity by an additional 25 basis points translates to an additional $3,285,458 that would flow through to the ratepayers.[1085] Rather, any savings from effective operating and maintenance cost measures should flow through to ratepayers and investors.[1086]

Accordingly, I recommend that the Commission deny the Company's request for an adder of 0.25% for management performance. Moreover, based on the foregoing discussions, I recommend that the Commission adopt I&E's proposed overall rate of return of 7.26%.

1081 PECO St. 1, pp. 13-22; PECO St. 1-R, p. 15.
1082 PECO St. 2, pp. 5-6.
1083 PECO St. 5, p. 52; PECO M.B., pp. 68-71.
1084 I&E St. No. 2, p. 47.
1085 *Id.*, p. 46.
1086 I&E St. No. 2-SR, p. 35.

G. <u>Customer Programs and Miscellaneous Issues</u>

1. PECO's Position

a. Recommendations Related to the COVID-19 Emergency

PECO maintains that it has been proactive in seeking to assist customers throughout the COVID-19 pandemic. As detailed by PECO witness Kelly A. Colarelli, the Company has implemented offerings benefitting all residential customers as well as those who participate in universal service programs. Since March 2020, PECO has offered all residential customers the opportunity to enter into a 24-month payment agreement. The Company has utilized multiple strategies to inform customers about this special payment agreement and facilitated enrollment through automated processes. With respect to its universal service programs, on December 17, 2020, the Commission approved PECO's proposal to temporarily modify the eligibility requirements for the Company's hardship fund (the Matching Energy Assistance Fund or MEAF) to expand the number of customers who may qualify for assistance.[1087] The Company also filed a COVID-19 relief proposal on June 26, 2020, that included, among other things, a bill credit for CAP customers, temporary waivers of certain requirements for CAP enrollment and recertification, and a transfer of unspent Low-Income Usage Reduction Program (LIURP) funds to a summer cooling initiative.[1088] The relief proposal remains pending before the Commission. Finally, in accordance with Commission orders at Docket No. M-2020-3019244, the Company implemented a variety of COVID-19 relief measures, including a moratorium on termination of service and waiver of connection fees and deposits for reconnection of service.[1089] PECO MB at 80-81.

[1087] *Petition of PECO Energy Company (PECO) to temporarily amend its current 2016-2018 Universal Service and Energy Conservation Plan (2016 USECP)*, Docket Nos. P-2020-3022124 and M-2015-2507139 (Secretarial Letter issued Dec. 17, 2020).

[1088] *Petition of PECO Energy Company for Public Meeting August 6, 2020 Expedited Approval of Temporary Universal Service Measures To Address COVID-19 Related Economic Hardship And Provide Additional Opportunities For Electric Usage Reduction*, Docket No. P-2020-3020555.

[1089] *See* PECO St. 10-R, pp. 3-4.v

OCA witness Roger D. Colton recommended an Emergency COVID-19 Relief Program for residential customers who are in arrears, are not eligible for or participating in CAP, and provide proof of unemployment benefits or receipt of the first federal COVID-19 relief check. The Relief Program would have four primary benefits: (1) access to a long-term payment arrangement; (2) screening for CAP and MEAF eligibility; (3) suspension of collection efforts; and (4) a one-time bill credit of up to $400.[1090] PECO MB at 81.

The Company does not believe that Mr. Colton's recommendations are necessary or appropriate in light of the Company's existing COVID-19 response and the Commission's continuing direction on collections matters during the pandemic. As examples, the Company is already providing *all* residential customers with access to a payment agreement with a term up to 24 months and *any* residential customer that identifies a financial difficulty is provided with information about PECO's universal service programs. As to collections activity, the Company believes it is appropriate to continue to act consistently with the Commission's directives at Docket No. M-2020-3019244, which the Commission issued after extensive consideration of the views of many stakeholders.[1091] PECO MB at 82.

Additionally, PECO asserts that 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.[1092] 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 longer payment arrangement being granted to customers based on income information. For all these reasons, the ERP should be rejected by the Commission. PECO RB at 52-53.

1090 *See* OCA Sch. RDC-1; OCA St. 5, p. 27.
1091 *See* PECO St. 10-R, p. 5.
1092 *See* PECO St. 10-R, p. 6.

b. Universal Service Programs

PECO's proposed 2019-2024 Universal Service and Energy Conservation Plan (2019-2024 USECP) is pending before the Commission at Docket No. M-2018-3005795. The 2019-2024 USECP contains the Company's proposed universal service program terms, budgets and customer outreach and educations plans. Significantly, the 2019-2024 USECP changes the format of PECO's Customer Assistance Program (CAP) from a Fixed Credit Option (FCO) to a Percentage of Income Payment Plan (PIPP). Under the PIPP, a CAP customer would receive a bill credit based upon his or her annual income and the applicable energy burden (EB) percentage. PECO has proposed to adopt recommended EBs from the Revised CAP Policy Statement[1093] for customers at 0-50% and 51-100% of the federal poverty level (FPL) and maintain PECO's existing EBs for customers at 101-150% of the FPL. The PIPP also incorporates reduced minimum bill amounts and new customer notifications if a customer approaches maximum credit amounts.[1094] PECO MB at 82.

PECO expects the PIPP to improve bill affordability for all CAP income groups as compared to the current FCO. Subject to minimum bill and maximum credit amounts, a CAP customer's credit would increase under the PIPP to ensure the customer continued to pay no more than the applicable EB. Given the time that will be required to transition to a PIPP, PECO has also sought Commission approval to utilize the recommended EBs from the Revised CAP Policy Statement as part of the FCO until the Company transitions from the FCO to its PIPP.[1095] PECO MB at 83.

In this proceeding, both OCA witness Colton and CAUSE-PA witness Miller expressed concern that the percentage of low-income customers enrolled in CAP is too low.[1096] As explained by Ms. Colarelli, however, these concerns are misplaced because PECO's CAP participation rate, as defined by the Commission, is 77.5% and the highest of any Pennsylvania

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1093 *2019 Amendments to Policy Statement on Customer Assistance Program, 52 Pa. Code § 69.261–69.267,* Docket No. M-2019-3012599 (Order entered Nov. 5, 2019). 50 Pa. B. No. 12 at 1691-1695 (Mar. 21, 2020).

1094 *See* PECO St. 10-R, p. 8.

1095 *See* PECO St. 10-R, pp. 8-9. *See also* Docket No. P-2020-3022154.

1096 *See* OCA St. 5, pp. 33-36; CAUSE-PA St. 1, pp. 22-23.

natural gas distribution company.[1097] In addition, the Company has proposed an expanded outreach and education program for gas and electric customers as part of its 2019-2024 USECP.[1098] PECO MB at 83.

Mr. Miller also had multiple recommendations for PECO's CAP, LIURP and MEAF. While the Company has provided specific responses to these recommendations, as detailed below, PECO believes that proposed changes to its universal service programs should be considered in the 2019-2024 USECP proceeding and not in a base rate proceeding. All parties would benefit from having a complete view of the Company's universal service proposals, including all program-specific details and budgets. PECO MB at 83.

Mr. Miller recommended the following changes to PECO's CAP: (1) adopt the EBs in the Revised CAP Policy Statement; (2) adjust the credit under the FCO to immediately account for any base rate increase; (3) develop a plan to increase CAP enrollment by 50% by 2025; (4) move arrears from CAP customers into pre-program arrearage forgiveness; (5) waive all late fees and reconnection fees; and (6) waive income certification requirements until the pandemic is over.[1099] PECO MB at 84.

Ms. Colarelli explained that most of the CAP issues identified by Mr. Miller are either pending before the Commission or already being implemented by the Company. As noted previously, PECO has made specific EB proposals for both the remaining period of the FCO and the PIPP in the 2019-2024 USECP proceeding. Consistent with the Commission's recent findings in *Columbia Gas*, PECO believes that EB and CAP credit calculation issues should not be considered separately from other parts of the Company's universal service programs.[1100] Similarly, with respect to Mr. Miller's CAP enrollment concerns, the 2019-2024 USECP proceeding already includes the Company's proposal for an expanded outreach and education program. Enrollment plans, along with other CAP issues such as arrearage forgiveness, are

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[1097] *See* PECO St. 10-R, pp. 5-6; PECO Ex. KC-1-R.
[1098] *See* PECO St. 10-R, p. 10.
[1099] *See* CAUSE-PA St. 1, pp. 30-34, 39-41.
[1100] *Columbia Gas*, p. 160 (finding that a utility's EB levels "should not be considered separately from other parts of [the utility's] CAP and universal service programs but should be considered as part of [the utility's] entire universal service plan, including the need for changes and associated costs").

better suited for the 2019-2024 USECP proceeding than a gas base rate proceeding.[1101] Finally, regarding Mr. Miller's remaining issues, the Company is already waiving late fees and reconnection fees in accordance with Commission Orders at Docket No. M-2020-3019244, the Company no longer assesses late fees to CAP customers in accordance with the Revised CAP Policy Statement, and PECO's proposal to temporarily waive written income documentation requirements remains pending before the Commission.[1102] PECO MB at 84-85.

Mr. Miller recommended the following changes to LIURP: (1) increase the budget by $2 million for an annual budget of $4,250,000; (2) establish a per-job $2,000 health and safety budget to remediate health and safety issues that prevent LIURP services; (3) make the Company's heating pilot program a permanent part of the LIURP at the current annual funding level of $700,000; (4) adopt a lower high usage threshold for multifamily units; and (5) adopt a policy of rolling over any unspent LIURP funds to the next year.[1103] PECO MB at 85.

Ms. Colarelli explained that PECO's LIURP proposals, including overall program funding, spending limitations and high-usage thresholds are all pending before the Commission at Docket No. M-2018-3005795. In addition, almost doubling the budget, as Mr. Miller proposes, is unrealistic and would not change the size of PECO's eligible customer pool. Finally, any decision about making the *electric* heating pilot permanent is premature without final data, and, in any event, should not be made in a *gas* base rate proceeding. The Company's position is consistent with *Columbia Gas*, where the Commission adopted the presiding ALJ's finding that funding for Columbia's health and safety pilot should not be changed until the effectiveness of the program can be evaluated.[1104] PECO MB at 85.

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

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1101 Notably, PECO's gas-only CAP population (300 customers) is a very small part of its total gas and electric CAP population (114,000). *See* PECO St. 10-R, p. 10.
1102 *See* PECO St. 10-R, p. 9-10.
1103 *See* CAUSE-PA St. 1, pp. 34-37.
1104 *Columbia Gas*, p. 174.

any remaining balance, and utilize pipeline refunds to increase MEAF funding by $2 million.[1105] PECO MB at 85-86.

As previously discussed, the Company has already implemented several temporary modifications to MEAF requirements to expand the number of customers who may qualify for assistance. In addition, PECO does not believe the zero-balance requirement should be waived because MEAF is not intended to be a supplemental grant program but rather a means to address collections risk by achieving a zero balance. Finally, the Company believes its current MEAF budget is appropriate and does not support the diversion of pipeline refunds to MEAF. Those refunds are currently applied to reduce the Purchased Gas Cost ("PGC") and, therefore, the diversion proposed by Mr. Miller would increase the PGC paid by non-shopping PECO customers, including residential customers.[1106] PECO MB at 86.

c. Neighborhood Gas Pilot Rider

The Company is proposing to extend the NGPR for five years beginning July 1, 2021, and to increase the annual NGPR cost to $7.5 million.[1107] The Company is also proposing to modify the NGPR in two ways. First, the Company will provide the first 40 feet of gas main extension to each prospective residential natural gas customer at no cost, subject to unanticipated ground conditions or unusual permit requirements. Second, the Company will modify the calculation of the contribution in aid of construction (CIAC) by assuming that 66% of prospective customers would take service during the first year of the extension. This differs from the current program where the Company assumes that 66% of prospective customers will join over 20 years.[1108] PECO MB at 86.

Mr. Keller agreed with the Company's proposal to provide 40 feet of main extension per contracted customer at no cost with certain limitations for abnormal underground conditions or unusual permit requirements.[1109] But Mr. Keller also recommended that the CIAC

1105 *See* CAUSE-PA St. 1, pp. 38-39.
1106 *See* PECO St. 10-R, pp. 11-12.
1107 *See* PECO St. 9, pp. 12-14.
1108 *See* PECO St. 9, pp. 10-13; *see also* PECO St. 8, p. 13.
1109 *See* I&E St. 2, pp. 49-50.

calculation remain the same i.e., assume 66% of customers join over 20 years instead of in year one. Mr. Keller based his objection to changing the CIAC calculation on the fact that the Company had spent just $15 million of its $25 million spending limit during the first five years of the NGPR, and because COVID-19 may impact customer willingness to pay for natural gas service.[1110] For these reasons, Mr. Keller also recommended that the cost of the NGPR remain at $5 million per year.[1111] PECO MB at 86-87.

Mr. Keller's recommendations are unsupported and should be rejected. First, the Company has seen rapid uptake of natural gas service by potential customers. This shows that the assumption that 66% of customers will take service over 20 years should be updated to better align with NGPR data. Second, the Company continued to see strong interest in the NGPR in 2020 despite the impacts of the COVID-19 pandemic. Based on customer interest in the NGPR, the Company expects installed projects to increase by 25 neighborhoods per year under the revised program. This projected growth would require the full $7.5 million budget requested by the Company in this case.[1112] PECO MB at 87.

PECO argues that 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. PECO further argues that I&E's proposed budget, if approved, would unnecessarily limit customer participation in the program, while increasing program capital costs without increasing the budget, thus limiting 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.[1113] For all of these reasons, the Company submits that its request should be approved. PECO MB at 87; PECO RB at 56.

1110 *See* I&E St. 2, pp. 50-51.
1111 *See* I&E St. 2, p. 50.
1112 *See* PECO St. 9-R, pp. 10-12.
1113 *See* PECO St. 9-R, p. 11.

d. Energy Efficiency and Conservation Programs

PECO requested $4.5 million in annual funding for its EE&C program. As discussed by Ms. Masalta, the Company requested an increase in the EE&C budget to expand program offerings for both residential and low-income customers, fund pilot projects for emerging technologies, and use targeted marketing and customer outreach to increase customer participation in the program.[1114] The following summarizes PECO's proposed EE&C program, responds to specific concerns raised by I&E witness Patel and OCA witness Crandall, and explains why the Commission should approve the Company's requested allocation. PECO MB at 87-88.

The Company proposed three new offerings for residential customers: an ENERGY STAR®+ furnace rebate, rebates for faucet aerators and showerheads, and a smart thermostat rebate. The Company also proposed doubling the existing rebate for ENERGY STAR® storage hot water heaters.[1115] Mr. Patel did not oppose "[the] introduction of new rebate programs."[1116] Mr. Crandall fully supported the proposed low-flow aerator and showerhead programs at PECO's requested budget level.[1117] Mr. Crandall also supported PECO's ENERGY STAR® furnace and smart thermostat rebate programs, but with a reduced budget.[1118] And Mr. Crandall opposed the residential boiler and storage hot water heater programs and claimed that these individual measures fail the TRC test for cost-effectiveness.[1119] PECO MB at 88.

For low-income customers, the Company proposed a new Safe and Efficient Heating Program. This program would serve low-income customers who are not currently eligible for a Low-Income Usage Reduction Program (LIURP) heating audit. The program would include a site visit and unit inspection, provide information on unit maintenance along with extra filters, and install a carbon monoxide detector. PECO would also replace a limited number of furnaces and boilers as part of this program.[1120] Mr. Crandall fully supported this

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1114 *See* PECO St. 9, pp. 6-8; *see also* PECO St. 9-R, pp. 4-6.
1115 *See* PECO St. 9, pp. 6-7.
1116 *See* I&E St. 1, p. 34; OCA St. 6, pp. 19-21.
1117 *See* OCA St. 6, p. 33.
1118 *See* OCA St. 6, pp. 31-33.
1119 *See* OCA St. 6, pp. 31-32.
1120 *See* PECO St. 9, pp. 7-8.

program at PECO's requested budget of $1,000,000 per year.[1121] Mr. Patel stated that he did not oppose new programs but did not address this program specifically.[1122] PECO MB at 88.

The Company's requested allowance also included funds for pilot projects to pursue emerging technologies that would reduce gas consumption, improve safety, or both.[1123] Although Mr. Crandall recognized that pilot programs are "potentially useful," he recommended not funding this program.[1124] As stated, Mr. Patel did not oppose this or any new programs.[1125] PECO MB at 88-89.

As previously noted, Mr. Patel recommended a disallowance of $1,772,500 and that the Company's EE&C program budget be set at $2,727,500 per year (a 39% decrease from the Company's request).[1126] Mr. Crandall recommended that the Company's request for new funding be denied and that EE&C program funding remain at $2,008,000 per year. Messrs. Patel and Crandall both argued that the Company's requested increase was not needed because past program participation did not meet expectations and the Company only spent 74% of its annual collection.[1127] The Company disagrees. PECO MB at 89.

The Company recognizes that past customer participation levels have not met projections and that program expenditures have been less than budgeted amounts. The Company's proposed budget, however, will support expanded program offerings to encourage customer participation by giving them more ways to participate and includes funding for targeted marketing campaigns that, while more expensive, the Company believes will increase customer participation.[1128] The Company's EE&C program is also cost effective at the portfolio level, with a TRC of 1.02.[1129] Finally, if less than $4.5 million is spent, the unspent funds will be

1121 *See* OCA St. 6, pp. 33-34.
1122 *See* I&E St. 1, p. 34.
1123 *See* PECO St. 9, p. 8.
1124 *See* OCA St. 6, p. 34.
1125 *See* I&E St. 1, p. 34.
1126 *See* I&E St. 1, p. 34; *see also* I&E St. 1-SR, pp. 27, 32.
1127 *See* I&E St. 1, pp. 34-36; I&E St. 1-SR, 29-30; OCA St. 6, pp. 27-29; OCA St. 6-SR, pp. 12-14.
1128 *See* PECO St. 9, pp. 6-9; PECO St. 9-R, pp. 4-7.
1129 *See* PECO St. 9-R, pp. 3-4.

returned to customers.[1130] For these reasons, the Company believes that the Commission should approve its requested allowance for the EE&C program. PECO MB at 89.

Regarding CAUSE-PA's recommendation to increase access to EE&C programs for low-income customers, PECO notes 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".[1131] 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.[1132] In other words, the SEHP is not only focused on efficiency but also on safety. PECO RB at 57.

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".[1133] PECO RB at 57.

e. Quality of Service – Distribution Integrity Management Programs

PECO manages its natural gas distribution system in a safe and reliable manner that meets or exceeds federal and state pipeline operational requirements. To ensure safe and

[1130] *See* PECO St. 9, p. 10.
[1131] *See* CAUSE-PA M.B., p. 39.
[1132] *See* PECO St. 9, p. 7.
[1133] *See* PECO St. 9-R, p. 9.

reliable pipeline operations, PECO complies with pipeline safety regulations under 49 C.F.R. Part 192 and the applicable provisions of the Pennsylvania Code under Title 52, Chapter 59. The federally-mandated Distribution Integrity Management Program (DIMP) is PECO's company-specific plan used to identify and resolve risks to the distribution system. The DIMP provides a rigorous framework for analyzing, ranking, and mitigating threats, and evaluating the effectiveness of those risk mitigation actions.[1134] PECO MB at 90.

The implementation of the DIMP plan is based on the following seven areas of focus: (1) System Knowledge; (2) Threat Identification; (3) Risk Evaluation and Ranking; (4) Identification and Implementation of Measures to Address Risks; (5) Performance Measurements, Results Monitoring and Evaluation of Effectiveness; (6) Periodic Evaluation and Improvement; and (7) Reporting Results. DIMP activities in each of these focus areas play a critical role in driving PECO's risk reduction and safety and reliability improvement initiatives.[1135] In particular, the Company monitors its compliance with each prescribed element of the DIMP plan in order to evaluate PECO's performance in meeting the applicable standards and to reassess threat levels and mitigation measures in light of new information and evolving conditions on the Company's system. Additionally, the Company regularly reviews and assesses the many factors affecting its distribution system to identify risk and determine the best mitigation strategy. PECO MB at 90.

As noted above, a key component of the DIMP is Risk Evaluation and Ranking. The Company performs the evaluation by evaluating a number of risk categories in its risk model. The Company calculates scores for those categories and creates a relative risk ranking to measure the performance of one group of assets compared to another.[1136] The DIMP identified the following top ten risks to its gas distribution system: ***** BEGIN CONFIDENTIAL***** [redacted]

1134 PECO St. 1, pp. 14-15.
1135 PECO St. 1, p. 15.
1136 PECO St. 1-R, p. 5.

[redacted].[1137] PECO MB at 91.

[redacted].[1138] [redacted].[1139] PECO MB at 91.

[redacted]

[1137] *See* I&E Ex. No. 4.
[1138] I&E St. 4-SR pp. 2-3.
[1139] *See* PECO St. 1-R, pp. 4-5; PECO Ex. RAB-1-R.

[redacted]. ***END CONFIDENTIAL*** PECO MB at 91-92.

In her direct and surrebuttal testimony, Ms. Bozhko expressed concerns that PECO has been ineffective at reducing corrosion risk on bare steel main and services. *** BEGIN CONFIDENTIAL*** [redacted].[1140] [redacted].[1141] PECO MB at 92.

[redacted].[1142] [redacted].*** END CONFIDENTIAL***PECO MB at 92-93.

f. Quality of Service – Leaks and Excavation Damage

*** **BEGIN CONFIDENTIAL*****[redacted].[1143] PECO MB at 93.

1140 I&E St. 4, p. 10.
1141 I&E St. 4-SR, pp. 4-5.
1142 PECO St. 1-R, p. 8.
1143 PECO St. 1-R, p. 10.

[redacted].[1144] [redacted].[1145] PECO MB at 93.

[redacted].[1146] [redacted].[1147] [redacted].[1148] [redacted].[1149] ***** END CONFIDENTIAL*****

PECO MB at 93-94.

1144 I&E St. 4-SR, p. 5.
1145 PECO St. 1-R at 10.
1146 I&E St. 4, p. 15; I&E St. 4-SR, p. 6.
1147 Hearing Tr. 224.
1148 I&E St. 4-SR, p. 6.
1149 Hearing Tr. 224.

Moreover, PECO uses a widely accepted industry damage rate metric for benchmarking that includes the total locate tickets received as part of the calculation, consistent with federal regulations. A closer review of the 2015 to 2019 period better reflects the impact of PECO's damage reduction approaches. ***** BEGIN CONFIDENTIAL***** [redacted].[1150] ***** END CONFIDENTIAL***** PECO MB at 94.

2. I&E's Position

a. Recommendations Related to the COVID-19 Emergency

I&E did not brief this specific issue.

b. Universal Service Programs

I&E did not brief this specific issue.

c. Neighborhood Gas Pilot Rider

I&E recommends allowing up to 40 feet of main line per contracted residential customer at no cost with certain limitations such as abnormal underground conditions or unusual permit requirements as stated by the Company.[1151] I&E also continues to recommend an annual allowance of $5,000,000 ($25,000,000 ÷ 5 years) for the capital costs associated with the proposed change to the NGPR or a reduction of $2,500,000 ($7,500,000 - $5,000,000) to the Company's claim.[1152] I&E MB at 60-61.

[1150] Hearing Tr. 225-26.
[1151] I&E St. No. 2, pp. 49-50 PROPRIETARY; I&E St. No. 2-SR, p. 39.
[1152] *Id.*

The I&E recommendation is based on the fact that the Company has only spent $15,500,000 since the beginning of the NGPR despite having a spending limit of $25,000,000.[1153] I&E argues, this demonstrates the Company has not spent the amount currently allocated to the NGPR.[1154] I&E's recommendation was also based on the Company's current CIAC calculation which assumes 66% of customers would take service over a 20-year period; however, only 44% of eligible customers have taken service since the inception of the NGPR.[1155] I&E MB at 61; I&E RB at 37.

The Company stated it is revising the CIAC calculation to assume that 66% of potential customers will contract for service in the first year to better align with data from the NGPR.[1156] Further, the Company suggested that there will be an increased interest in participating in the NGPR as a result of the 40 feet of main line per contracted residential customer and the revised CIAC calculation.[1157] The Company notes that customers are expressing interest in participating in the NGPR but are awaiting the outcome of this proceeding and the Company expects an increase of 25 neighborhoods per year under the revised NGPR which would require the Company's initial $7,500,000 claim.[1158] I&E MB at 61.

I&E disagrees and asserts the Company may be able expand its program sufficiently to achieve its originally projected targets, but there is no data to support increasing the funding for this program at this time based on historic performance where there was a decrease in inquiries regarding the NGPR, the number of main extension projects, and number of residential customers having gas available from the NGPR from 2019 to 2020.[1159] Additionally, although the Company's revised CIAC calculation assumes 66% of customers would take service in the first year, only 44% of eligible customers have taken service since the inception of the NGPR.[1160] I&E MB at 62; I&E RB at 37.

1153 *Id.*, pp. 50-51, *citing* PECO St. No. 9, pp. 11-12.
1154 I&E St. No. 2, p. 50; I&E St. No. 2-SR, pp. 37-38.
1155 I&E St. No. 2-SR, p. 38, *citing* PECO St. No. 9, p. 11.
1156 PECO St. No. 9-R, p. 11.
1157 *Id.*
1158 *Id.*
1159 I&E St. No. 2-SR, p. 40.
1160 *Id.*

Therefore, in consideration of the record evidence and the arguments presented in this proceeding, I&E continues to recommend allowing up to 40 feet of main line per contracted residential customer at no cost with certain limitations such as abnormal underground conditions or unusual permit requirements as stated by the Company.[1161] Further, I&E also continues to recommend an annual allowance of $5,000,000 ($25,000,000 ÷ 5 years) for the capital costs associated with the proposed change to the NGPR or a reduction of $2,500,000 ($7,500,000 - $5,000,000) to the Company's claim.[1162] I&E MB at 62.

d. Energy Efficiency and Conservation Programs

I&E's stated positions regarding PECO's energy efficiency and conservation programs and the associated costs is set forth in Section V.D.2.m of this Recommended Decision. Additionally, I&E submits that promising to return unspent monies to customers regarding a program in which past customer participation levels have not met projections and program expenditures have been less than the budgeted amounts, is not substantial credible evidence supporting a claimed need for increased funding to the underperforming program. I&E RB at 37-38.

e. Quality of Service – Distribution Integrity Management Programs

The DIMP is a performance based regulatory program applicable to gas distribution operators driven by risk management.[1163] The federal Pipeline and Hazardous Materials Safety Administration ("PHMSA") created the DIMP[1164] regulations to reduce the number of Department of Transportation ("DOT") reportable incidents.[1165] Two of the main causes of reportable incidents are pipeline leaks caused by corrosion and damage to pipelines caused by third parties.[1166] I&E MB at 63.

1161 *Id.*, p. 39.
1162 *Id.*
1163 I&E St. No. 4, p. 3.
1164 *See* Code of Federal Regulations, Chapter 49, Part 192.1001-192.1015, Subpart P.
1165 *Id.*
1166 *Id.*

I&E indicates that it made recommendations regarding PECO's Distribution Integrity Management Program in I&E witness Elena Bozhko's PROPRIETARY direct and surrebuttal testimony.[1167] The focus of I&E's recommendations is to improve PECO's methodology for both monitoring and reducing risk and damage to the PECO distribution system. I&E further indicates that it is not intending to be hypercritical of PECO's existing methodology, but rather to recommend improvements. I&E notes that, for purposes of brevity and to avoid including large amounts of proprietary information in its Brief, I&E instead refers the reader to Ms. Bozhko's PROPRIETARY direct and surrebuttal testimonies where the confidential discussions and recommendations can be found. I&E MB at 63; I&E RB at 38.

I&E notes that PECO correctly identifies the controlling federal and state statutes and regulations in its main brief,[1168] and correctly states that the federally-mandated Distribution Integrity Management Program provides utilities with a methodology to use to identify and resolve risks to the distribution system which includes a rigorous framework for analyzing, ranking, and mitigating threats, and evaluating the effectiveness of those risk mitigation actions.[1169] I&E RB at 38-39.

I&E acknowledges that PECO witness Ronald Bradley provided confidential responses in rebuttal and oral rejoinder testimony regarding Ms. Bozhko's recommendations.[1170] Nevertheless, I&E continues to recommend the suggested methods to both monitor and reduce risk and damages to the PECO distribution system. I&E MB at 64.

f. Quality of Service – Leaks and Excavation Damage

I&E reiterates that two of the main causes of reportable incidents are pipeline leaks caused by corrosion and damage to pipelines caused by third parties.[1171] And, as I&E previously stated, I&E continues to recommend the suggested methods to both monitor and

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[1167] *See* I&E St. No. 4 PROPRIETARY, pp. 6-24; I&E St. No. 4-SR PROPRIETARY, pp. 7-9.
[1168] PECO MB, p. 90.
[1169] *Id.*
[1170] *See* PECO St. No. 1-R, p. 8; Hrg. Tr.
[1171] I&E St. No. 4, p. 3.

reduce risk and damages to the PECO distribution system as discussed in I&E witness Bozhko's PROPRIETARY direct and surrebuttal testimonies.[1172] I&E MB at 64.

3. OCA's Position

a. Recommendations Related to the COVID-19 Emergency

In light of the significant long-term economic crisis created by the COVID-19 Pandemic, OCA witness Colton proposed an Emergency COVID-19 Relief Plan (ERP) to provide financial and collections relief to residential customers, in particular those low-wage customers that may not have access to other forms of assistance.[1173] The ERP proposal includes a forward-looking process timeline for the relief plan to conclude on December 31, 2021.[1174] The timeline also provides that the parties to the proceeding would meet thirty days prior to the termination date to discuss a possible further extension of benefits.[1175] The ERP also includes cost recovery through a deferral mechanism so as to not increase current rates until the full extent of the pandemic and its economic consequences are known.[1176] The Company has already proposed a relief program for small business customers, and the OCA submits that a relief plan should also be implemented for residential customers.[1177] OCA MB at 127.

The details for the Emergency COVID-19 Relief Plan are specifically laid out in Mr. Colton's Schedule RDC-1. Customers would be eligible if they met the following criteria:

> i. Any residential customer meeting the following qualifications will be eligible for the program: (i)The customer is a current customer in arrears; and (ii)The customer is not participating or eligible for CAP; and (iii)The customer provides the following:
>
> 1. proof of unemployment benefits filed/received for one or more household members on March 13, 2020; or

1172 *See* I&E St. No. 4 PROPRIETARY, pp. 6-24; I&E St. No. 4-SR PROPRIETARY, pp. 2-9.
1173 OCA St. 5 at 27, Sch. RDC-1.
1174 OCA St. 5 at Sch. RDC-1, ¶ 4.
1175 OCA St. 5 at Sch. RDC-1, ¶ 4.
1176 OCA St. 5 at 27, Sch. RDC-1, ¶ 4.
1177 OCA St. 5 at 27.

> 2. proof the customer, or a member of the customer's household, is eligible for, or has received, the first federal COVID-19 relief check in the amount of $1,200.[1178]

OCA MB at 127-128.

The Emergency COVID-Relief Plan would provide to eligible customers the following benefits:

> b. Residential customer ERP benefits shall include:
>
> i. Upon enrollment, suspension of collection efforts for any amounts due for service beginning as of the March 2020 billing cycle and continuing through the duration of the shutoff restrictions adopted pursuant to paragraph 1; and
>
> ii. Upon enrollment, a customer shall be entitled to a one-time credit (up to $400) in an amount equal to 25% of the customer's applicable balance as of the ERP Enrollment Termination Date (defined below).
>
> iii. All ERP customers will be screened for CAP and MEAF eligibility, and those who may be eligible will be encouraged to apply for the most appropriate program to address their needs.
>
> iv. For customers determined to be ineligible for CAP, any remaining current applicable balance shall be subject to a long-term deferred payment arrangement (including the suspended amount). For purposes of establishing a deferred payment arrangement for applicable balances, the Company shall offer payment arrangement terms consistent with section 1405(b) or 24 months, whichever is longer, unless a shorter arrangement is affirmatively agreed to by the consumer. Longer payment arrangements may be offered to ERP participants at the discretion of the Company.[1179]

OCA MB at 128.

The ERP program is designed to extend beyond low-income customers. The economic crisis is not limited to low-income customers, and the OCA submits that a broader-

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[1178] OCA St. 5 at Sch. RDC-1, ¶ 1(c).
[1179] OCA St. 5 at Sch. RDC-1, ¶ 2(b).

reaching program is needed. OCA witness Colton recommended consideration of the self-sufficiency standard for a COVID-19 Relief Plan. The ERP proposal would provide much-needed economic relief to customers that have demonstrated an impact from the COVID-19 Pandemic and are otherwise having challenges paying their arrearages but do not have access to other resources. OCA MB at 129.

The Commission has the broad legal authority to order the ERP proposal to provide collection relief and assistance to residential customers during this COVID-19 Pandemic. The OCA notes that PECO has proposed a similar program for small business customers.[1180] The Commission has broad authority to address a utility's customer service and quality of service under Section 1501 of the Public Utility Code.[1181] Section 1504 of the Public Utility Code provides:

> The commission may, after reasonable notice and hearing, upon its own motion or upon complaint:
>
> (1) Prescribe as to service and facilities, including the crossing of facilities, just and reasonable standards, classifications, regulations and practices to be furnished, imposed, observed and followed by any or all public utilities.[1182]

In the context of a base rate case, evaluation of the "efficiency, effectiveness, and adequacy of service" by the Commission is affirmatively required.[1183] Further, in its consideration whether to maintain existing rates or as a condition of any rate increase, the Commission has authority to order improvements to service.[1184] OCA MB at 129-130.

In Rebuttal Testimony, PECO witness Colarelli testified that a COVID-19 relief plan is not necessary because "any residential customer that identifies a financial difficulty is provided with information about PECO's universal service programs."[1185] The OCA submits

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[1180] OCA St. 5 at 28.
[1181] 66 Pa. C.S. § 1501.
[1182] 66 Pa. C.S. § 1504.
[1183] 66 Pa. C.S. § 523(a).
[1184] *Pa. Pub. Util. Comm'n v. Pa. Gas & Water Co.*, Docket No. R-850178, 74 PUR4th 238, 244-45 (1986) (*PG&W 1986*); 66 Pa. C.S. § 1501 (every public utility shall make all changes and improvements to service as shall be necessary to make such service adequate, efficient, safe, and reasonable).
[1185] PECO St. 5-R at 10.

that this proposal is not sufficient to address the financial problems of either confirmed low-income customers, the near-poor customers or low-wage earners. As the OCA identified in Direct Testimony, PECO significantly under-enrolls its confirmed low-income customer population in CAP.[1186] PECO has only enrolled 25.8% of its confirmed low-income customer population in CAP, meaning that 74.2% of confirmed low-income customers are not enrolled in program.[1187] The OCA submits that information alone is not sufficient to address the economic impact on low-income customers. OCA MB at 130.

The OCA submits that Company witness Colarelli also assumes that only a low-income residential customer will have financial difficulties and need assistance. Ms. Colarelli misses the point of Mr. Colton's testimony. As discussed in OCA witness Colton's testimony, low-wage and near-poor customers also need assistance that the Company is not currently providing through its universal service programs. OCA MB at 130.

PECO witness Colarelli also testified that the Company is providing a sufficient response because PECO is providing a $50 credit to CAP customers.[1188] While the OCA supports the Company's proposal to provide assistance to PECO's CAP customers, the response does not address the financial issues experienced by PECO's near-poor and low-wage customers who do not qualify for CAP. The proposal also does not provide assistance to the 74.2% of PECO's low-income customers that are not enrolled in CAP. OCA MB at 131.

Finally, PECO witness Colarelli testified that the Company's proposal to offer customers a 24-month payment arrangement is a sufficient response to COVID-19 for all other residential customers.[1189] The OCA submits that the proposed maximum 24-month payment arrangement is neither sufficient nor consistent with Chapter 14.[1190] OCA MB at 131-132.

1186 OCA St. 5 at 34.
1187 OCA St. 5-SR at 13.
1188 PECO St. 5-R at 10.
1189 PECO St. 5-R at 10.
1190 *See*, 66 Pa. C.S. § 1405(b).

The OCA submits that the PECO's COVID-19 relief proposal is also not consistent with Section 1405(b) of the Public Utility Code. Ratepayers should already be eligible for a longer payment arrangement than PECO proposes to offer to customers as part of COVID-19 relief assistance. OCA MB at 132.

PECO's proposed COVID-19 assistance does not recognize the need for assistance for low-wage and near-poor customers. The ERP is designed to extend beyond low-income customers that qualify for PECO's universal service programs. The OCA's proposed COVID-19 Emergency Relief Plan would provide assistance to those near-poor, low-wage, low-income non-CAP residential customers that are struggling due to the public health and economic crisis. The proposal provides important and needed relief for residential customers. The ERP also sets forth a plan for cost recovery for the Company so the Plan can be implemented without the need for a rate increase for the Company. For the reasons set forth in OCA witness Colton's testimony, the OCA submits that OCA witness Colton's COVID-19 Emergency Relief Plan should be approved. OCA MB at 132; OCA RB at 70.

b. Universal Service Programs

In Rebuttal Testimony, OCA witness Colton addressed three of CAUSE-PA witness Miller's recommendations: (1) to increase the PECO Gas energy burdens for its Customer Assistance Program (CAP) as a part of this proceeding; (2) to implement an in-CAP arrearage forgiveness program; and (3) to increase CAP enrollment by 50%.[1191] The OCA submits CAUSE-PA's issues related to energy burdens be addressed as a part of the pending *TURN v. PECO*[1192] complaint proceeding and PECO's pending USECP proceeding.[1193] CAUSE-PA's recommendations related to increasing CAP enrollment should also be addressed as a part of the pending USECP proceeding.[1194] OCA MB at 133; OCA RB at 70.

1191 CAUSE-PA St. 1 at 28-33, 40; OCA St. 5-R at 2-15.

1192 *Tenant Union Representative Network v. PECO Energy Co.*, Docket No. C-2020-3021557 (*TURN v. PECO*).

1193 OCA M.B. at 133-138.

1194 OCA M.B. at 138-142.

i. Energy Burdens

CAUSE-PA witness Miller proposed to lower the energy burdens for PECO Gas CAP customers in this proceeding to the energy burdens identified in the Commission's *Final CAP Policy Statement Order*.[1195] Mr. Miller's proposal would be to lower the PECO gas energy burdens to 4% for customers at 0-50% of the Federal Poverty Level (FPL) and 6% for customers from 51-150% of the FPL as a part of this base rate proceeding.[1196] OCA witness Colton testified that the energy burdens for PECO's gas CAP program should not be changed as a part of this base rate proceeding because the matter is already pending in two other proceedings before the Commission. Moreover, Mr. Colton testified that the *Final CAP Policy Statement Order* specifically identified that the changes should be made as a part of the Company's Universal Service and Energy Conservation Plan (USECP) filing.[1197] PECO witness Colarelli similarly testified that the issue of energy burdens is already pending in other proceedings.[1198] OCA MB at 133.

The Commission's *Final CAP Policy Statement Order* anticipated that the utilities would address the energy burdens in their USECPs, and not in a base rate proceeding.[1199] In the Commission's *OCA Reconsideration Order,* the Commission specifically provided:

> We remind stakeholders that the maximum energy burden percentages in the Annex to the November 5 Order are recommendations, not iron-clad limits on what a utility can charge a CAP household. Issues related to a specific utility's energy burdens are still subject to scrutiny in that utility's USCEP proceedings.[1200]

1195 *See* CAUSE-PA St. 1 at 27-31. *See also, 2019 Amendments to Policy Statement on Customer Assistance Programs, 52 Pa. Code §§ 69.261-69.267*, Docket No. M-2019-3012599, Order at 9-32 (Nov. 5, 2019) (*Final CAP Policy Statement Order*).

1196 *See,* 52 Pa. Code § 69.265(2)(i)(A).

1197 OCA St. 5-R at 3-9.

1198 PECO St. 10-R (Revised) at 9.

1199 *Final CAP Policy Statement Order* at 2.

1200 *2019 Amendments to Policy Statement on Customer Assistance Program, 52 Pa. Code §§ 69.261-69.267,* Docket No. M-2019-3012599, Order at 10-11 (Feb. 6, 2020) (Feb. 6, 2020) (*OCA Reconsideration Order*).

The OCA submits that the purpose of a review in the Company's USECP is so the entire plan can be reviewed as a whole with consideration of all interrelated provisions of the Final CAP Policy Statement. OCA MB at 134.

The Commission agreed in the *Columbia* base rate proceeding that the energy burdens should not be changed as a part of the base rate proceeding, but instead should be evaluated as a part of the Company's Universal Service and Energy Conservation Plan proceeding.[1201] In the *Columbia* base rate proceeding, the Commission provided:

> Based on our review of the record and the applicable law, we find that issues related to Columbia's energy burden levels are more properly considered in the context of the Company's next USECP filing. We agree with Columbia and the OCA that the energy burdens of customers on PIP Plans should not be considered separately from other parts of the Company's CAP and universal service programs but should be considered as part of the Company's entire universal service plan, including the need for changes and associated costs. As the OCA's witness Mr. Colton aptly testified, an evaluation of whether additional cost controls, such as minimum payment terms, consumption limits, high usage treatments, and maximum CAP credits, should also be evaluated within a USECP proceeding. OCA St. 5 at 20. Our determination on this issue is consistent with our prior statements in the *February 2020 Reconsideration Order* that issues related to a specific utility's energy burdens will be subject to strict scrutiny in that utility's USECP proceeding. *February 2020 Reconsideration Order* at 10-11.[[1202]]

OCA MB at 134-135.

Moreover, the Commission is already considering the PECO gas energy burdens as a part of two other on-going proceedings. If the issue were to be addressed as a part of this base rate proceeding as well as the two pending Commission proceedings, it would create the

1201 *Columbia Gas* at 160-161.
1202 *Columbia Gas* at 161.

potential for three inconsistent implementation dates and decisions regarding the energy burden changes. OCA MB at 135-136.

The OCA submits that Mr. Miller's proposal also does not take into consideration that PECO's CAP program serves both natural gas customers and electric customers, but this base rate proceeding would only address PECO's natural gas customers. Consideration of the energy burdens as a part of the pending Universal Service and Energy Conservation Plan proceeding would allow the Commission to evaluate the energy burdens for both PECO gas and PECO electric. OCA MB at 136-137.

Finally, the energy burdens are only one component of the CAP program, and as the *Columbia Gas* decision correctly noted, the CAP Policy Statement does not consider the energy burdens in a vacuum.[1203] CAUSE-PA witness Miller's proposal to change the energy burdens in this proceeding does not take into consideration the potential impacts to other elements of the USECP. The need for additional cost controls, such as changes to the minimum payments or maximum cap credits, must be evaluated as a part of the USECP. For this reason, the *OCA Reconsideration Order* specifically provided that proposed changes to the energy burdens should be filed as a part of the Company's amendments to its Universal Service and Energy Conservation Plan.[1204] OCA MB at 137.

The *OCA Reconsideration Order* provided that changes to the energy burdens should be considered as a part of the utility-specific USECP.[1205] For PECO, there are currently two on-going proceedings that will review the energy burdens as a part of the Universal Service and Energy Conservation Plan. In the on-going Universal Service and Energy Conservation Plan proceeding, the Commission will be able to evaluate the energy burdens for both PECO Electric and PECO Gas. The OCA submits that the Commission should not approve the proposed changes to the energy burdens in this proceeding. Any proposed changes to the energy burdens

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1203 *Columbia Gas* at 161.
1204 *OCA Reconsideration Order* at 10-11; *Final CAP Policy Statement Order* at 2.
1205 *OCA Reconsideration Order* at 10-11.

should be evaluated along with any necessary cost control measures as a part of PECO's Universal Service and Energy Conservation Plan. OCA MB at 138.

ii. In-CAP Arrearage Forgiveness Program

CAUSE-PA witness Miller recommended "rolling debts accrued through the pandemic into pre-program arrearages."[1206] As support for his recommendation, Mr. Miller argued that "PECO's current CAP is not providing affordable bills, and the pandemic has exacerbated the economic struggle for low-income households across the board."[1207] As OCA witness Colton described, the proposal is limited to customers who participated in CAP throughout the pandemic.[1208] Mr. Colton recommended that CAUSE-PA witness Miller's proposal be deferred to PECO's currently pending USECP proceeding. OCA witness Colton reasoned that the proposal would create a substantive change to the CAP program and should be considered along with all other changes recommended for PECO's CAP in the USECP proceeding.[1209] OCA MB at 138.

Moreover, OCA witness Colton testified that consideration of the proposal as a part of the USECP proceeding would allow CAUSE-PA witness Miller to present additional important programmatic and operational details that were not otherwise included in his Direct Testimony.[1210] In Rebuttal Testimony, OCA witness Colton identified examples of the lacking programmatic details which make it impossible to know precisely what the full recommendation is.[1211] OCA MB at 138-139.

OCA witness Colton identified several important operational details that were not included in Mr. Miller's Direct Testimony. In Surrebuttal Testimony, CAUSE-PA witness Miller suggested that these identified issues could be addressed in a stakeholder process, but the OCA submits that a more complete proposal is necessary to evaluate the need for the

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1206 CAUSE-PA St. 1 at 40.
1207 CAUSE-PA St. 1 at 40.
1208 OCA St. 5-R at 10.
1209 OCA St. 5-R at 11.
1210 OCA St. 5-R at 11-12.
1211 OCA St. 5-R at 12.

proposal.[1212] As OCA witness Colton expressed in his Rebuttal Testimony, however, without the programmatic and operational details, Mr. Colton was not able to make an appropriate response to the proposal. OCA MB 139-140.

Accordingly, the OCA submits that Mr. Miller's proposed in-program arrearage forgiveness program should not be approved as a part of this base rate proceeding. As OCA witness Colton recommended, the proposal for an in-program arrearage forgiveness program should be evaluated in the context of PECO's on-going USECP proceeding. OCA MB at 140.

iii. Increasing CAP Enrollment by 50%

CAUSE-PA witness Miller recommended that PECO be required to benchmark its CAP enrollment and increase CAP enrollment by 50% by 2025.[1213] Mr. Miller, however, did not include a specific proposal regarding how to achieve the objective either in his Direct or Surrebuttal Testimony. CAUSE-PA witness Miller proposed instead that "[r]ather than [prescribe] the specific methods for improved enrollment through this proceeding, the Commission should require PECO to work with its stakeholders to identify the most workable solutions to achieve measurable improvements in CAP enrollment."[1214] In his Direct and Rebuttal Testimonies, OCA witness Colton agreed with Mr. Miller that PECO's CAP is under-enrolled, but Mr. Colton's testimony on that issue was instead directed towards Mr. Colton's concerns about the financial impact of the proposed increase to the customer charge on low-income customers.[1215] While the OCA agrees that PECO should improve its CAP enrollment, the OCA submits that issues related to PECO's CAP enrollment should be addressed as a part of the Company's Consumer Education and Outreach Plan that is part of its pending Universal Service and Energy Conservation Plan. OCA MB at 140-141.

In Rebuttal Testimony, OCA witness Colton noted that Mr. Miller's CAP enrollment recommendation closely resembles the language in the Commission's *Final CAP*

1212 CAUSE-PA St. 1-SR at 16.
1213 CAUSE-PA St. 1 at 33.
1214 CAUSE-PA St. 1 at 33.
1215 OCA St. 5 at 34; OCA St. 5-R at 15, Exh. RDC-1R.

Policy Statement Order and recommended that the details of Mr. Miller's proposal be set forth as part of PECO's pending USECP proceeding.[1216] The *Final CAP Policy Statement Order* provided:

> While there is no specific regulatory mandate that each utility must enroll a certain percentage of low-income households in CAP, the near uniform disparity between the total number of potential income-qualified households and those actually receiving assistance calls into question the overall adequacy of consumer education and outreach. Consumer Education and Outreach Plans are paramount to customer awareness of, and enrollment in, universal service programs. Therefore, we are expanding the current CAP Policy Statement in order to provide more guidance on this central matter.[1217]

OCA MB at 141.

Similar to Mr. Miller's recommendation in this proceeding, the *Final CAP Policy Statement Order* directed utilities to develop an enhanced Consumer Education and Outreach Plan with input from stakeholders and submit the Plans as addendums to existing Universal Service Plans and their USECP filings going-forward.[1218] The *Final CAP Policy Statement Order* provided:

> While utilities have flexibility as to the contents of their plans, the plans should reflect focused consumer education and outreach efforts, tailored to the demographics of their individual service territories, spanning the duration of the universal service plan period. In particular, these plans should identify efforts to educate and enroll eligible and interested customers at or below 50% of the FPIG. The Consumer Education and Outreach Plans will be reviewed by BCS and by the Commission's Office of Communications.[1219]

OCA MB at 141-142.

The OCA submits that the *Final CAP Policy Statement Order* provides for each utility to include an education and outreach plan in its USECP to increase CAP enrollment. The

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1216 OCA St. 5-R at 14. *See also, Final CAP Policy Statement Order* at 78.
1217 *Id.*
1218 *Id*. at 78-79.
1219 *Id*. at 79 (footnotes omitted).

Final CAP Policy Statement Order also provides that there should be a stakeholder process to review those Consumer Education and Outreach Plans. As OCA witness Colton testified, "it would appear that this now-pending review of PECO's USECP is precisely the appropriate place to address the problems identified by Mr. Miller and the "under-enrollment" identified in my Direct Testimony."[1220] The OCA submits that CAUSE-PA witness Miller's recommendation to increase CAP enrollment by 50% by 2025 should be addressed as a part of PECO's pending Universal Service and Energy Conservation Plan. OCA MB at 142.

c. Neighborhood Gas Pilot Rider

The OCA did not brief this specific issue.

d. Energy Efficiency and Conservation Programs

The Company is seeking approval to expand its existing EE&C programs, which, if approved, will more than double its existing EE&C budget for its residential programs from $2.008 million to $4.5 million per annum. While EE&C programs serve an important purpose, the Company has failed to demonstrate that the proposed expansion is just and reasonable and in the public interest. More specifically, the evidence demonstrates that the Company failed to fully expend its existing budget since their inception and the Total Resource Cost (TRC) test demonstrates that PECO's proposed expansion is not cost-effective at worst and marginally cost-effective at best. Thus, the Company has failed to support its request in this proceeding. OCA MB at 143.

Therefore, the OCA recommends that the Commission (1) deny the Company's proposed increase to its voluntary natural gas EE&C portfolio, (2) re-allocate its existing budget consistent with the recommendation of OCA witness Geoffrey Crandall, (3) require the Company to perform and provide Evaluation, Measurement, and Verification (EMV) studies of its EE&C programs, and (4) require the Company, consistent with its residential program reconciliation mechanism, to track unspent funds for its commercial EE&C programs and

[1220] OCA St. 5-R at 15.

propose a plan to return those amounts to commercial customers in the Company's next base rate proceeding.[1221] OCA MB at 143.

Regarding OCA witness Crandall's recommendations, Mr. Crandall testified that the Company should re-allocate its existing budget amongst the programs proposed by PECO in a way that is more cost-effective and targeted.[1222] OCA witness Crandall recommended the following EE&C Portfolio funded at the Company's existing budget:[1223]

Comparison of PECO and OCA Recommended Budgets		
Program/Portfolio	PECO 2021 and beyond Programs	OCA Recommendations
Residential Efficient Furnace	$1,507,500	$518,000
Residential Super-Efficient Furnace	$250,000	$75,000
Residential Boiler	$150,000	$0
Residential Storage Water Heater	$25,000	$ 0
Residential Smart Thermostat	$332,500	$50,000
Residential Aerators and Showerheads	$65,000	$65,000
Low Income S&EHP	$1,000,000	$1,000,000
Residential Emerging Technologies Pilot	$125,000	$0
Commercial Efficient Furnace	$12,000	$12,000
Commercial Efficient Boiler	$10,500	$10,500
Education/Admin/CSP admin	$1,050,625	$300,000
Annual Total	$4,528,125	$2,030,500

OCA MB at 154-155.

Per the above chart, Mr. Crandall recommended reducing the budgeted amounts for the Residential Efficient Furnace, Residential Super-Efficient Furnace, Residential Smart Thermostat, and Residential Aerators and Showerheads programs. Mr. Crandall explained that the furnace and smart thermostat programs were not cost-effective under PECO's TRC analysis, but some funding should continue for these programs as it will likely be cost-effective when

1221 *See* OCA St. 6 at 29-38.
1222 *See* OCA St. 6 at 30.
1223 OCA St. 6 at 30.

considering the seasonal avoided costs and considering these programs can help customers install long-lived assets, such as furnaces.[1224] OCA MB at 155-156.

Moreover, Mr. Crandall's proposed budget eliminates the residential boiler, storage water heater, and emerging technologies pilot programs. Mr. Crandall testified that the residential boiler and residential storage water heater programs fail the Company's TRC analysis and would likely continue to do so even taking into account the appropriate avoided costs.[1225] With respect to the residential emerging technologies pilot, Mr. Crandall testified that the program not be funded at this time due to the very substantive and pressing need for PECO customers to reduce and eliminate energy waste, rather than focus on experimental technologies.[1226] OCA MB at 156.

Additionally, OCA witness Crandall also recommended that the Company reduce its administrative costs from PECO's proposed $1,045,000 annually ($1,050,625 including the commercial programs) to $300,000 per year.[1227] Also, Mr. Crandall supported the Company's proposed Low-Income Safe and Efficient Heating Program, recommending that the full request of $1 million be included within his proposed portfolio.[1228] Lastly, OCA witness Crandall did not contest PECO's reconciliation adjustment for its residential EE&C programs, which will return any unspent funds back to ratepayers as a credit to the USFC. Rather, Mr. Crandall requested that the Company also apply this reconciliation mechanism to its commercial EE&C program budget, so that "[i]f there are unspent funds, the procedure should ensure that those funds are credited back to commercial customers or used for the benefit of its commercial customers."[1229] OCA MB at 158.

In summation, Mr. Crandall recommended that (1) the Commission adopt his recommended EE&C portfolio and maintain the Company's existing budgets amounts, (2) PECO increase its efforts to market these programs and get customers to participate, and (3) PECO

1224 OCA St. 6 at 20, 30-33.
1225 OCA St. 6 at 31-32.
1226 OCA St. 6 at 34.
1227 OCA St. 6 at 34-35.
1228 OCA St. 6 at 33-34.
1229 OCA St. 6 at 35-36.

return any unspent funds for its Commercial EE&C programs back to commercial customers. OCA MB at 158.

Accordingly, OCA asserts that the Commission should adopt the proposal of OCA witness Crandall and deny the Company's proposed increase to its natural gas EE&C programs. Adoption of this adjustment would reduce the Company's claimed expense by $2.492 million.[1230] In addition, the Company's existing budget should be re-allocated consistent with the proposal of OCA witness Crandall.[1231] The Commission should require the Company to track unspent funds for its commercial EE&C program budget to ensure that those funds are credited back to commercial customers or used for the benefit of its commercial customers.[1232] Lastly, the Commission should require the Company to perform and submit EMV studies for these programs in its next base rate proceeding.[1233] OCA MB at 160.

e. Quality of Service – Distribution Integrity Management Programs

The OCA did not brief this specific issue.

f. Quality of Service – Leaks and Excavation Damage

The OCA did not brief this specific issue.

4. OSBA's Position

The OSBA did not brief any of the customer program or miscellaneous issues.

1230 *See* OCA. St. 2 at 41; *see also* OCA St. 2, Sch. LKM-26.
1231 *See* OCA St. 6 at 30.
1232 OCA St. 6 at 35-36.
1233 OCA St. 6 at 37-38.

5. CAUSE-PA's Position

a. Recommendations Related to the COVID-19 Emergency

CAUSE-PA argues that PECO's customers are in dire need of emergency assistance to help ensure that economically vulnerable households are able to remain connected to critical natural gas services. At existing rates, even for CAP customers, service is objectively unaffordable for low-income households – costing families upwards of 20% or more of their income on energy costs alone. The global pandemic, which has fallen hardest on low-income communities, and communities of color, has exacerbated long-standing unaffordability – leading to the accrual of unprecedented levels of consumer debts and a staggering number of residential consumers eligible for termination.

- As of November 2020, before the winter heating season really began, residential utility debt was ***up 187% year over year ($46.2 million to $122.3 million)*** across PECO's gas and electric divisions.[1234]

- By December 2020, nearly 140,000 of PECO's residential customers were facing pending termination by the end of December 2020.[1235]

CAUSE-PA MB at 15-16.

As CAUSE-PA witness Miller explained in his Direct Testimony, "low-income termination rates during the Great Recession provide an insightful look at the impact of a far-ranging economic crisis on low income consumers' ability to remain connected to essential utility services."[1236] *At the height of the Great Recession in 2008, 87.9% (nearly 9 out of 10) of PECO's confirmed low income natural gas customers were terminated for nonpayment.[1237]* In comparison, just 6.2% of all residential customers – including low income customers – were terminated for nonpayment in that same year.[1238] The grave economic and health impact of the

[1234] CAUSE-PA St. 1 at 15.
[1235] CAUSE-PA St. 1-SR at 8.
[1236] CAUSE-PA St. 1 at 20.
[1237] *Id.*
[1238] *Id*

pandemic on low income families and communities of color across the state was detailed above, and for the sake of brevity we will not reiterate those crucial facts – CAUSE-PA incorporates them in this section to elucidate the dire need for comprehensive utility assistance and relief from mounting utility debts.[1239] CAUSE-PA MB at 16.

To help alleviate the impact of the pandemic on PECO's residential consumers, and specifically on economically vulnerable low-income consumers, Mr. Miller recommended a number of comprehensive, short-term policies and programs, including:

- Increase funding for PECO's Hardship Fund program by $2 million, through the use of pipeline penalty credits and refunds.[1240]
- Waive the current burdensome requirement that hardship fund recipients achieve a zero dollar balance as a condition to issuing a grant, even if the balance could be deferred for forgiveness through enrollment in CAP or otherwise addressed through a long term payment arrangement.[1241]
- Waive income certification requirements for enrollment in CAP until the state is no longer under a state of emergency.[1242]
- Provide arrearage forgiveness for arrears accrued while in CAP.[1243]
- Waive late fees and reconnection fees for at least one year after a final order in this proceeding is issued.[1244]

CAUSE-PA believes each of these recommendations will help provide much needed assistance to those impacted by the pandemic, and will help to ensure that low and moderate income families – including those who may find themselves in poverty for the very first time – can maintain access to critical natural gas services to their homes.[1245] CAUSE-PA MB at 17.

1239 *See* CAUSE-PA St. 1 at 14-20.
1240 CAUSE-PA St. 1 at 38.
1241 CAUSE-PA St. 1 at 39.
1242 CAUSE-PA St. 1 at 39.
1243 CAUSE-PA St. 1 at 40.
1244 CAUSE-PA St. 1 at 41.
1245 CAUSE-PA Main Brief at 16-17.

i. Increase Funding for PECO's Hardship Fund

PECO was recently approved to expand the eligibility for its Hardship Fund grant assistance, known as the Matching Energy Assistance Fund, from 175% FPL to 200% FPL, a fact that PECO touts in arguing that no additional pandemic relief is necessary. But as Mr. Miller pointed out through his Direct and Surrebuttal testimony, unlike its peers across the state, PECO did not propose any commensurate increase in the dollars available to assist the tens of thousands of residential consumers who have fallen behind on their natural gas bill through the pandemic.[1246] In other words, PECO merely "increased the number of customers eligible for the same amount of grant assistance."[1247] Without increasing the MEAF budget to serve more customers, PECO's expanded eligibility will not adequately address the unprecedented economic crisis that residential consumes face.[1248] CAUSE-PA MB at 17.

To help address the ongoing and unfolding pandemic, and the categorical unaffordability of PECO's existing rates, CAUSE-PA urges the Commission to require PECO to increase its MEAF funding by $2 million. We propose that PECO fund this increase through the use of penalty pipeline credits and refunds, which would represent a very small portion of the total available pipeline penalty credits and refunds.[1249] For the period July 1, 2019 through December 31, 2020, the amount of pipeline penalty credits and refunds collected by PECO amounted to over $18 million.[1250] CAUSE-PA MB at 17-18.

PECO argues that it cannot use pipeline penalty credits and refunds in this manner because the funds are used to offset the Purchased Gas Cost.[1251] But this ignores the fact that many other natural gas utilities have been approved to use pipeline credits and refunds in this manner.[1252] In balance, the impact to the Purchase Gas Cost would be extremely limited – amounting to a de minimis benefit to residential ratepayers – while the benefit to those facing

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1246 CAUSE-PA St. 1 at 38; CAUSE-PA St. 1-SR at 6.
1247 CAUSE-PA St. 1-SR at 6.
1248 *Id.*
1249 CAUSE-PA St. 1-SR at Appendix B, CAUSE-PA to PECO III-3(a).
1250 *Id.*
1251 PECO St. 10-R at 12.
1252 CAUSE-PA St. 1 at 38.

extreme hardship would be life altering, and would provide additional benefits to residential customers as a whole through reduced arrears and other collections costs that are ultimately borne by residential consumers.[1253] CAUSE-PA MB at 18.

Notably, PECO argues that its $250,000 budget for MEAF across its natural gas and electric divisions "is appropriate,"[1254] but fails to provide any evidence or explanation for its conclusion that $250,000 in funding will be adequate to assist over 140,000 residential consumers to address the more than $122 million in arrears accrued as a result of extreme economic hardships created by the pandemic. As Mr. Miller concluded in testimony, "The crisis we face is unprecedented, and calls for creative solutions to ensure that economically vulnerable consumers facing untold economic hardship are able to maintain natural gas services to their home."[1255] CAUSE-PA MB at 18.

ii. Waive Burdensome Hardship Fund Requirements

CAUSE-PA argues that, in addition to being inadequately funded to address the current crisis, PECO's Hardship Fund (MEAF) also imposes burdensome requirements on applicants – issuing grants only when the grant will bring the balance to zero. As Mr. Miller explains, "this is despite the fact that low-income customers who are eligible for MEAF may be eligible for a long-term payment arrangement that, combined with grant assistance, would help improve affordability, prevent termination, and stabilize the household's access to natural gas services."[1256] PECO is the only utility in the state with this burdensome requirement for those facing acute hardship. CAUSE-PA MB at 19.

To help address the unprecedented utility debt crisis, and stabilize low-income families' access to natural gas service, CAUSE-PA urges the Commission to require PECO to waive this burdensome requirement for the duration of the pandemic. CAUSE-PA asserts that this simple proposal is both just and reasonable and will help ensure that households

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1253 CAUSE-PA St. 1-SR at 11.
1254 PECO St. 10-R at 12
1255 CAUSE-PA St. 1 at 38.
1256 CAUSE-PA St. 1 at 39.

experiencing an acute economic hardship can maintain access to natural gas service. CAUSE-PA MB at 19.

iii. Waive Income Certification for CAP During State of Emergency

The pandemic has presented a number of unique challenges for households to obtain and submit documentation, as libraries and other businesses remain closed to the public. PECO has already waived recertification requirements, but it is not clear how long this waiver will continue.[1257] As Mr. Miller explained, "this flexibility should continue until all businesses are fully reopened and the state is no longer under a state of emergency."[1258] CAUSE-PA urges the Commission to require that PECO continue this flexibility while Pennsylvania remains in a state of emergency, and develop a transition plan to allow consumers to recertify over a reasonable period of time after the emergency period ends.[1259] It would be both unjust and unreasonable to require thousands of consumers to provide documentation of income all at once – without an organized transition plan. CAUSE-PA MB at 19-20.

iv. Provide Arrearage Forgiveness for In-CAP Arrears

To help equitably alleviate the debt accrued by low income and vulnerable families as a result of the global pandemic, CAUSE-PA asserts that PECO should be required to roll arrears accrued by CAP customers into preprogram arrearage forgiveness. CAUSE-PA MB at 20.

CAUSE-PA's proposal to equitably address arrears for PECO's very low-income customers – instead of pursuing termination as a means to collect – drew criticism from OCA witness Roger Colton, who argued that the proposal lacked specificity. But as Mr. Miller explained in response, the program is actually quite simple – and, given the urgency and uncertainty surrounding the pandemic – minor implementation issues can and should be worked

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1257 CAUSE-PA St. 1 at 39.
1258 *Id*.
1259 *Id*.

out through a stakeholder process.[1260] As detailed in Mr. Miller's testimony, the record clearly supports the need for relief for low income CAP customers to reasonably – and equitably – address the unprecedented and disproportionate level of hardship caused by the pandemic on low income utility consumers.[1261] CAUSE-PA MB at 20.

CAUSE-PA's proposal is a reasonable and targeted approach to achieve equitable resolution of debt. As Mr. Miller explained, those who are income eligible for CAP – but are not yet in the program – would not need in-program arrearage forgiveness, as their arrears would be eligible for forgiveness by simply entering the program.[1262] On the other hand, "current CAP customers do not have a path to address arrears accrued through the pandemic – nor do they have the opportunity to access a payment arrangement from the Commission" to otherwise resolve debt accrued during the pandemic.[1263] In that way, the relief is targeted – in that it assists those without other avenues to earn forgiveness on debt accrued through the pandemic. CAUSE-PA's proposal is also measured, and is responsive to inequities created by existing unaffordability within CAP. As Mr. Miller explained, "CAP customers were already exceeding PECO's current energy burden standards by substantial margins prior to the onset of the pandemic, making it even more likely that many CAP customers have been unable to keep up with their CAP bills as the pandemic has progressed."[1264] Providing arrearage forgiveness to CAP customers for debts accrued through the pandemic "presents a just and reasonable path forward to address the unprecedented crisis facing low income communities."[1265] CAUSE-PA MB at 21.

Finally, it is critical to keep in mind that the cost of CAUSE-PA's proposal to equitably address CAP arrears is minimal – *amounting to between $0.19 and $0.34 per month for residential consumers*.[1266] While any increase in rates must always be carefully scrutinized and weighed, this modest increase – in balance – is both just and reasonable and will help to ensure

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1260 CAUSE-PA St. 1-SR at 16.
1261 *Id*.
1262 CAUSE-PA St. 1-SR at 16; OCA St. 5-R at 10.
1263 *Id*. *Citing* 66 Pa. C.S. § 1405(c).
1264 CAUSE-PA St. 1 at 22; CAUSE-PA St. 1-SR at 16.
1265 CAUSE-PA St. 1-SR at 17.
1266 CAUSE-PA St. 1-SR at 17.

that PECO's most economically vulnerable customers are able to maintain affordable natural gas services to their home. CAUSE-PA MB at 21-22.

v. Waive Late Fees and Reconnection Fees for One Year

As a final component to CAUSE-PA's proposed pandemic response programming, CAUSE-PA asserts that PECO should waive late fees and reconnection fees for at least one year after a final order is issued in this proceeding.[1267] As it stands, and as the evidence discussed above plainly illustrates, the economic devastation in low income communities is likely to persist for a long period of time – even after the immediate public health threat subsides.[1268] Low income consumers are likely to continue to struggle to pay their bills on time – and will face unprecedented levels of termination. It is important that late fees and reconnection fees continue to be waived to allow low-income consumers to regain economic stability in the wake of the pandemic. Otherwise, these fees could act merely as a punitive punishment for being poor – heaping additional costs on top of already unaffordable levels of debt. CAUSE-PA urges the Commission to order PECO to continue waiving late fees and reconnection fees for at least one year following a final order in this proceeding to help alleviate the extra financial burden on low-income consumers. CAUSE-PA MB at 22.

b. Universal Service Programs

i. Customer Assistance Program

CAUSE-PA maintains that PECO's CAP PECO's CAP is not producing affordable rates for low-income customers – a fact that CAUSE-PA believes will be further exacerbated by any increase in rates as a result of this proceeding.[1269] There are two primary reasons driving PECO's CAP unaffordability. First, PECO's current energy burden standards far exceed the standards adopted by the Commission, imposing a maximum combined energy

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[1267] CAUSE-PA St. 1 at 41.
[1268] CAUSE-PA St. 1 at 14-21.
[1269] CAUSE-PA St. 1 at 21-22.

burden of 17% of household income.[1270] Second, PECO's existing CAP program has also "continually failed to reach its own unacceptably high energy burden standards."[1271] According to a third-party evaluation, PECO's dual electric and gas CAP customers had an average energy burden of 20% in 2017 - "or roughly 1/5 of total household income."[1272] CAUSE-PA MB at 22-23.

Existing CAP unaffordability will be further exacerbated by any increase in rates – especially in the first year following any approved rate increase, when the percentage rate increase for CAP customers will actually *exceed* the percentage increase for other residential customers.[1273] This is because of the way PECO intends to adjust the applicable CAP rates quarterly – rather than at the time the rate increase is implemented.[1274] CAUSE-PA MB at 23.

PECO's intent to phase in CAP credit adjustments on a quarterly basis in the year following a rate increase contradicts the plain language of a 2015 Settlement approved by the Commission, which unambiguously provides: "*If PECO is granted a gas base rate increase, the portion of each rate R customer's Annual Credit that is attributable to distribution rates will be increased by a percentage equal to the system-wide residential gas distribution rate increase.*"[1275] On its face, this provision of the 2015 Settlement does not contemplate a lengthy phase-in, with incremental quarterly adjustments to the CAP credit over a 12-month period. To the contrary, it requires PECO to adjust the annual CAP credit by a percentage equal to the system-wide residential upon approval of any base rate increase. CAUSE-PA MB at 24.

1270 CAUSE-PA St. 1 at 21-22.*Citing* PECO Energy Company Universal Service and Energy Conservation Plan 2016-2018, at Addendum B, pg. 30 of 54 (Feb. 17, 2017), https://www.puc.pa.gov/pcdocs/1510970.pdf (hereinafter PECO USECP); 52 Pa. Code § 69.265. *See also* 2019 Amendments to Policy Statement on Customer Assistance Program, 52 Pa. Code § 69.261-69.267, *Final Policy Statement and Order*, Docket No. M-2019-3012599 (order entered Nov. 5, 2019) (hereinafter Final CAP Policy Statement and Order); PECO Energy Company Universal Service and Energy Conservation Plan for 2013-2015, Joint Petition for Settlement, Docket No. M-2012-2290911, at Exhibit A (filed March 20, 2015).

1271 CAUSE-PA St. 1 at 22.

1272 *Id.*

1273 CAUSE-PA St. 1 at 23, 33.

1274 *Id.*

1275 PECO Energy Company Universal Service and Energy Conservation Plan for 2013-2015, Joint Petition for Settlement, Docket No. M-2012-2290911, at Exhibit A, page 6 (filed March 20, 2015) (emphasis added).

While it is true that PECO has proposed in another proceeding to change the structure of its CAP to a percentage of income program, which – if approved – could insulate CAP customers from the impact of a rate increase, any change in PECO's CAP design will not be in effect in time to prevent CAP customers from facing a higher percentage increase in rates as a result of this rate proceeding. As Mr. Miller points out, "PECO is proposing to raise rates for all customers not, in this proceeding. Thus, unaffordability within CAP should likewise be addressed now, in this proceeding."[1276] CAUSE-PA MB at 24.

Important to this discussion, PECO's CAP only reaches a small portion of PECO's estimated eligible population. As of October 2020, only 20,147 customers were enrolled in CAP – representing less than 20% of PECO's estimated low income customer base, meaning roughly 80% of PECO's eligible customers and not enrolled in the program.[1277] "Despite a steadily growing residential customer base, stubborn poverty levels, and the emergence of an unprecedented economic crisis that is profoundly impacting low income customers, PECO's CAP enrollment has remained low" – and in fact has decreased by approximately 5,000 customers since 2010.[1278] As Mr. Miller explained, "If CAP is not reaching the eligible population, it cannot improve identified unaffordability for low income consumers."[1279] CAUSE-PA MB at 25.

To remediate existing unaffordability within CAP and mitigate the impact of any approved rate increase on CAP customers, CAUSE-PA submits that PECO should be ordered adhere to the following to ensure that CAP rates are just, reasonable, and in accordance with the law and policy:

- Adjust the applicable energy burden standards for PECO's natural gas CAP customers, consistent with the Commission's CAP Policy Statement, the terms of a prior Settlement, and PECO's currently effective Universal Service and Energy Conservation Plan (USECP).[1280]

1276 CAUSE-PA St. 1 at 24; see also CAUSE-PA St. 1-SR at 10.
1277 CAUSE-PA St. 1 at 22.
1278 CAUSE-PA St. 1 at 23, Chart 3.
1279 CAUSE-PA St. 1 at 23.
1280 CAUSE-PA St. 1 at 30-31.

- Upon implementation of any rate increase, adjust the CAP fixed credit limit by a percentage equal to the system-wide residential gas distribution rate increase, consistent with the terms of the 2015 Commission approved Settlement.[1281]

- Develop a plan to increase CAP enrollment 50% by 2025, from 20,147 to 30,221 – roughly 6% of PECO's residential customer population.[1282]

CAUSE-PA MB at 25.

ii. Low Income Usage Reduction Program

In testimony, CAUSE-PA witness Miller made several recommendations about PECO's LIURP.[1283] Mr. Miller explained that "PECO's LIURP program can play an important role in mitigating unaffordability for low-income consumers."[1284] However, he also explained that LIURP only serves a small portion of those in need of comprehensive energy efficiency and usage reduction services."[1285] CAUSE-PA MB at 30.

According to PECO's most recent universal service program needs assessment, 67,015 of PECO's gas service customers were estimated to be income eligible for LIURP services.[1286] However, in an average year, PECO provides LIURP services to approximately 1,000 low income consumers.[1287] Thus, Mr. Miller explained, "For LIURP to make a meaningful impact to remediate PECO's existing unaffordability and offset any impact of the proposed rate increase, PECO must make critical changes to its LIURP policies, procedures, and budget to expand usage reduction services to more households."[1288] Mr. Miller explained:

> PECO must take steps to serve additional households through its LIURP, including tenants and multifamily residents; to improve its health and safety program to remediate issues in the home that prevent PECO from performing comprehensive usage reduction services; and to ensure that PECO is able to provide services to those with an inoperable gas furnace

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1281 CAUSE-PA St. 1 at 23-24.
1282 CAUSE-PA St. 1 at 32-33.
1283 CAUSE-PA St. 1 at 25-26, 34-37.
1284 *Id.* at 25.
1285 *Id.*
1286 *Id.*
1287 *Id.*
1288 *Id.* at 25-26.

who may be relying on inefficient alternatives that are exacerbating other household energy costs. (Id.)

CAUSE-PA MB at 30.

To that end, Mr. Miller made the following recommendations:

- Increase LIURP Budget to Level Comparable to Similarly Sized NGDCs;
- Establish a $2,000 health and safety budget for LIURP jobs;
- Incorporate its de facto heating pilot program as a permanent part of its LIURP
- Improve Delivery of LIURP Services to Tenants and Multifamily Residents
- Establish a policy that any unspent LIURP funds will automatically roll over and be added to the LIURP budget for the following year.[1289]

CAUSE-PA MB at 30-31.

CAUSE-PA asserts that the Commission should adopt these just and reasonable recommendations to help mitigate existing rate unaffordability and offset the impact of PECO's proposed rate increase – which will fall hardest on high usage low-income customers.[1290] CAUSE-PA MB at 31.

Accordingly, CAUSE-PA requests that PEC be required to increase its LIURP budget to a level comparable to similarly sized NGDCs, to address health and safety barriers to LIURP participation, to incorporate its Defacto Electric Heating/Gas Furnace Repair & Replacement Program as a permanent part of its LIURP, to improve delivery of LIURP services to tenants and those who reside in multifamily buildings, and to ensure that unspent LIURP funds roll over and are readded to the next budget.

c. Neighborhood Gas Pilot Rider

CAUSE-PA did not brief this specific issue.

[1289] *Id.* at 34-37.
[1290] *See id.* at 26.

d. Energy Efficiency and Conservation Programs

As part of its rate filing, PECO has proposed to continue and expand its voluntary Energy Efficiency and Conservation (EE&C) program. While CAUSE-PA is generally supportive of EE&C initiatives, the low-income program component within PECO's EE&C Plan – known as the Safe and Efficient Heating Program – requires adjustment to ensure equitable and proportionate distribution of program benefits to economically vulnerable households.[1291] CAUSE-PA MB at 37.

The Safe and Efficient Heating Program is designed to target low-income homeowners with income at or below 100% FPL, and will replace a limited number of furnaces over 25 years old and boilers over 30 years old.[1292] The program will be administered by a Conservation Service Provider (CSP), and will be funded at $1 million – with an 11.6% administrative budget, or $116,134.[1293] CAUSE-PA MB at 37.

PECO projects that it will serve a total of 27,664 consumers through its EE&C Program, yet it will serve just 289 low-income customers through its Safe and Efficient Heating Program – amounting to just 1% of those served by PPL's EE&C Programs.[1294] Savings achieved for low income customers through the EE&C Program are also disproportionately low – and will achieve just 3,529 MCF savings for low income customers, compared to 492,983 MCF savings projected for the residential class.[1295] This amounts to just 0.72% of overall EE&C program savings.[1296] CAUSE-PA MB at 37-38.

CAUSE-PA is supportive of the direct installation services proposed to be provided through its Safe and Efficient Heating Program, as it will help to remediate heating costs for households with old and inefficient heating and hot water systems. These measures are not generally available to low-income households through other programming, which only

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[1291] CAUSE-PA St. 1 at 45.
[1292] CAUSE-PA St. 1 at 45.
[1293] *Id.* at 45-46.
[1294] CAUSE-PA St. 1 at 46.
[1295] *Id.*
[1296] *Id.*

provides services when a system is inoperable – not when it is inefficient and contributing to high energy costs for the participating household. CAUSE-PA MB at 38.

Notwithstanding this general support, CAUSE-PA is concerned about the lack of proportional EE&C programming for low-income consumers, who help to finance the programs through rates. PECO's voluntary, natural gas EE&C program is not strictly subject to the program standards enumerated in Act 129.[1297] That said, PECO's voluntary, rate-payer supported EE&C programs must still be just, reasonable, and in the public interest to be approved. In gauging whether PECO's EE&C program is in the public interest, CAUSE-PA asserts that the Commission should ensure that it aligns with analogous provisions in the law – including the requirements of Act 129 to provide a proportionate level of benefits to low income consumers.[1298] Importantly, Act 129 is explicit in its instruction that ratepayer supported EE&C programming – and the proportionate benefits for low income customers – must be "in addition to [LIURP] expenditures."[1299] Before approving PECO's proposed EE&C Program, CAUSE-PA asserts that the Commission should require PECO to include additional opportunities within its general residential program for low income consumers to access energy efficient equipment and programming without an upfront cost.[1300] CAUSE-PA MB at 38-39.

In addition to addressing issues with the proportionality, CAUSE-PA asserts that the eligibility standards for PECO's Safe and Efficient Heating Program are unreasonably restrictive in that it serves only homeowners – to the exclusion of tenants – and those with income at or below 100% FPL. CAUSE-PA urges expansion of the eligibility criteria to ensure that renters and those with income between 101-150% FPL can access these critically important energy efficiency services.[1301] CAUSE-PA MB at 39.

[1297] *See* 66 Pa. C.S. § 2806.1, *et seq.*

[1298] *See* 66 Pa. C.S. § 1301; 66 Pa. C.S. § 2806.1(b)(i)(G) ("The plan shall include specific energy efficiency measures for households at or below 150% of the Federal poverty income guidelines. The number of measures shall be proportionate to the households' share of the total energy usage in the service territory. The electric distribution company shall coordinate measures under this clause with other programs administered by the commission or another Federal or State agency. The expenditures of an electric distribution company under this clause shall be in addition to expenditures made under 52 Pa. Code Ch. 58 (relating to residential low-income usage reduction programs).").

[1299] 66 Pa. C.S. § 2806.1(b)(i)(G).

[1300] CAUSE-PA St. 1 at 48.

[1301] CAUSE-PA St. 1 at 47.

Finally, CAUSE-PA is concerned that PECO has not set forth any information – or made any mention – for how PECO's Safe and Efficient Heating Program will be coordinated with PECO's other low-income programs. As Mr. Miller explained in direct testimony, PECO "makes no mention of whether and to what exten[t] PECO will coordinate its voluntary EE&C programs with its Act 129 programming and other local, state, and federal programming, like the Weatherization Assistance Program."[1302] To remedy this lack of critical details, CAUSE-PA urges the Commission to require PECO to work with stakeholders and interested parties to develop a specific plan for coordinating its voluntary natural gas EE&C with other EE&C programs, including but not limited to LIURP, Act 129, and the Weatherization Assistance Program (WAP). PECO should be required to file this plan within six months of a final order in this proceeding.[1303] CAUSE-PA MB at 39.

In its review and approval of PECO's proposed EE&C Program, CAUSE-PA urges adoption of the above reforms to help ensure that available program benefits are equitably distributed to consumers most in need. CAUSE-PA MB at 40.

e. Quality of Service – Distribution Integrity Management Programs

CAUSE-PA did not brief this specific issue.

f. Quality of Service – Leaks and Excavation Damage

CAUSE-PA did not brief this specific issue.

6. PAIEUG's Position

PAIEUG did not brief any customer program or miscellaneous issues.

1302 CAUSE-PA St. 1 at 47.
1303 *Id.* at 48.

7. ALJ's Recommendations on Customer Programs and Miscellaneous Issues

a. Recommendations Related to the COVID-19 Emergency

Due to the ongoing COVID-19 pandemic, the OCA proposed an Emergency COVID-19 Relief Plan (ERP) to provide financial and collections relief to residential customers, particularly low wage customers that may not have access to other forms of assistance.[1304] For its part, CAUSE-PA proposed several short-term policies and programs to help alleviate the impact of the pandemic on economically vulnerable low-income consumers. The OCA argued that, pursuant to Section 1504 of the Public Utility Code,[1305] the Commission has broad legal authority to order the ERP proposal to provide collection relief and assistance to residential customers during this COVID-19 pandemic. The OCA further argued that, in its consideration whether to maintain existing rates or a condition of any rate increase, the Commission has the authority to order improvements to service.[1306]

PECO argued that it has been proactive in seeking to assist customers throughout the COVID-19 pandemic. PECO noted that it has implemented offerings benefitting all residential customers as well as those who participate in universal service programs. PECO explained that since the beginning of the pandemic, the company has: offered all residential customers the opportunity to enter into a 24-month payment agreement; utilized multiple strategies to inform customers about this special payment agreement and facilitated enrollment through automated processes; proposed (and received Commission approval) to temporarily modify the eligibility requirements for the Company's hardship fund (the Matching Energy Assistance Fund, or MEAF) to expand the number of customers who may qualify for assistance;[1307] filed a COVID-19 relief proposal on June 26, 2020 that included, among other things, a bill credit for CAP customers, temporary waivers of certain requirements for CAP

[1304] OCA St. 5 at 27, Sch. RDC-1.

[1305] 66 Pa. C.S. § 1504

[1306] *Pa. Pub. Util. Comm'n. v. Pa. Gas & Water Co.,* Docket No. R-850178, 74 PUR4th 238, 244-45 (1986) (*PG&W 1986*); 66 Pa. C.S. § 1501 (every public utility shall make all changes and improvements to service as shall be necessary to make such service adequate, efficient, safe and reasonable).

[1307] *Petition of PECO Energy Company (PECO) to temporarily amend its current 2016-2018 Universal Service and Energy Conservation Plan (2016 USECP)*, Docket Nos. P-2020-3022124 and M-2015-2507139 (Secretarial Letter issued Dec. 17, 2020).

enrollment and recertification, and a transfer of unspent Low Income Usage Reduction Program (LIURP) funds to a summer cooling initiative;[1308] and implemented a variety of COVID-19 relief measures in accordance with Commission Orders at Docket No. M-2020-019244. PECO does not believe additional proposals are necessary or appropriate in light of the Company's existing COVID-19 response and the Commission's continuing direction on collections matters during the pandemic.

I agree with the Company that the consumer protection proposals of the OCA and CAUSE-PA are not necessary at this time. The record shows that the Company has been proactive in trying to help its customers throughout the duration of this pandemic. Moreover, when the Commission recently lifted the termination moratorium, it recognized that there have been improvements in Pennsylvania:

> First, we acknowledge that even though Pennsylvania's COVID-19 diagnoses and deaths are decreasing from previous tragic peaks reached in 2020 and January of this year, and vaccinations have begun, the pandemic is not yet over. However, the pandemic's effect on the Commonwealth's unemployment numbers has changed. Pennsylvania's unemployment rate has improved from an astounding 16.2% in April 2020, to 10.2% in August 2020, to 7.1% in December 2020. This downward trajectory bodes well for Pennsylvania's economy if this trend continues. February 2021 Pennsylvania statistics are not yet available, but the national unemployment rate for February at 6.2%, represents a continuing downward trend.[1309]

Although the Commission lifted the moratorium on service terminations, the Commission implemented several modifications/protections to existing collection policies that shall apply to all electric, natural gas, water, wastewater, telecommunications, and steam utilities subject to the Commission's jurisdiction until December 31, 2021.[1310] These modifications/protections

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[1308] *Petition of PECO Energy Company for Public Meeting August 6, 2020 Expedited Approval of Temporary Universal Service Measures To Address COVID-19 Related Economic Hardship And Provide Additional Opportunities For Electric Usage Reduction*, Docket No. P-2020-3020555. PECO notes that this relief proposal is currently pending before the Commission.

[1309] *Public Utility Service Termination Moratorium* at 2, Docket No. M-2020-3019244 (Order entered March 18, 2021) (footnotes omitted).

[1310] *Id*. at 4.

provide temporary extensions on payment arrangement terms for residential and small business customers.

For all of the foregoing reasons, I agree with PECO that the consumer protection proposals of the OCA and CAUSE-PA are not necessary at this time, and recommend that they not be approved by the Commission.

b. Universal Service Programs

In an attempt to remediate existing unaffordability within PECO's CAP and mitigate the impact of any approved rate increase on CAP customers, CAUSE-PA proposed several modifications to PECO's CAP, including: requiring PECO to adjust its applicable energy burden standards;[1311] requiring PECO to immediately adjust the CAP fixed credit limit upon approval of any increase in rates;[1312] and requiring PECO to develop a plan to increase CAP enrollment 50% by 2025.[1313] CAUSE-PA also recommended several modifications to PECO's LIURP program, including: increasing LIURP budget to level comparable to similarly sized NGDCs; establishing a $2,000 health and safety budget for LIURP jobs; incorporate its defacto heating pilot program as a permanent part of its LIURP; improving delivery of LIURP services to tenants and multifamily residents; and establishing a policy that any unspent LIURP funds will automatically roll over and be added to the LIURP budget for the following year.[1314]

PECO and OCA both argued that CAUSE-PA's 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. As explained by the Company, the 2019-2024 USECP contains the Company's proposed universal service program terms, budgets and customer outreach and education plans. I agree with the Company that to consider universal service proposals in isolation and apart from

[1311] CAUSE-PA St. 1 at 30-31.
[1312] CAUSE-PA St. 1 at 23-24.
[1313] CAUSE-PA St. 1 at 32-33.
[1314] CAUSE-PA St. 1, at 34-37.

the 2019-2024 USECP proceeding would deny all parties a complete view of how such proposals may impact other parts of the USECP.

Moreover, regarding CAUSE-PA's CAP proposals, PECO explained that most of the issues raised are either pending before the Commission in other proceedings (adoption of new energy burdens, adjustment of the CAP credit after a rate increase, enhanced customer outreach) or already being implemented by the Company (waiving late fees and reconnection fees). 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.[1315] 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.

For all of the foregoing reasons, I agree with PECO and the OCA that CAUSE-PA's Universal Service Program proposals should be considered as part of the 2019-2024 USECP proceeding and recommend that they not be approved by the Commission at this time.

c. Neighborhood Gas Pilot Rider

The Company proposed to extend the NGPR for five years beginning July 1, 2021, and to increase the annual NGPR cost to $7.5 million. The Company also proposed to modify the NGPR by: providing the first 40 feet of gas main extension to each prospective residential natural gas customer at no cost, subject to unanticipated ground conditions or unusual permit requirements; and by modifying the calculation of the contribution in aid of construction by assuming 66% of prospective customers would take service during the first year of the extension. PECO explained that this differs from the current program where the Company assumes that 66% of prospective customers will join over 20 years.

[1315] *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.").

I&E agrees with the Company's proposal regarding the first 40 feet of gas main at no cost (subject to limitations) but recommended the annual allowance remain at $5 million for capital costs. I&E noted that its recommendation to keep the allowance the same was based on the fact that the Company has only spent $15,500,000 since the beginning of the NGPR despite having a spending limit of $25 million.

The Company argues that the new 40-foot allowance will generate increased customer interest in the NGPR.[1316] The Company further argues that the added cost of the 40-foot allowance alone justifies the annual $2.5 million allowance increase. However, the Company did not supply any data that would demonstrate support for the increased allowance, such as how the cost of the 40-foot allowance/increased interest would deplete the existing $5 million allowance.

I agree with I&E that there is no data to support increasing the funding for this program at this time based on historic performance. Accordingly, I recommend that the Commission approve the 40-foot gas main extension proposed by the Company, and I also recommend that the Commission allow an annual allowance of $5 million for the capital costs associated with the proposed change to the NGPR.

d. Energy Efficiency and Conservation Programs

The Company's request for $4.5 million in annual funding for its EE&C program was already addressed at Section V.D.7.m.

e. Quality of Service – Distribution Integrity Management Programs

I&E made recommendations regarding PECO's Distribution Integrity Management Program (DIMP). I&E noted that the purpose of its recommendations is to improve PECO's methodology for both monitoring and reducing risk and damage to the PECO distribution system.

[1316] PECO Statement No. 9-R at 11.

In response to I&E's recommendations, PECO witness Bradley described PECO's federally mandated DIMP used to identify and resolve risks to its gas distribution system. As noted by Mr. Bradley, the DIMP provides a rigorous framework for analyzing, ranking, and mitigating threats, and evaluating the effectiveness of those risk mitigation actions.[1317] ***** BEGIN CONFIDENTIAL ***** [redacted].[1318]

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

In light of Mr. Bradley's testimony, as well as the lack of any argument from I&E to the contrary, I agree with PECO that I&E's proposals should not be accepted and recommend that the Commission reject I&E's recommendations.

f. Quality of Service – Leaks and Excavation Damage

As with the DIMP, I&E noted that two of the main causes of reportable incidents are pipeline leaks cause by corrosion and damage to pipelines cause by third parties. As with the DIMP, I&E proposed recommendations to monitor and reduce risks and damages to the PECO distribution system.

*** **BEGIN CONFIDENTIAL** *** [redacted]

1317 PECO St. 1-R at 7.
1318 PECO St. 1-R at 8-9.

[redacted].[1319] [redacted].[1320]*** **END CONFIDENTIAL** ***

In light of Mr. Bradley's testimony, as well as the lack of any argument from I&E to the contrary, I agree with PECO that I&E's proposals should not be accepted and recommend that the Commission reject I&E's recommendations.

H. Rate Structure

1. PECO's Position

a. Cost of Service

i. PECO's Class Cost of Service Study

Jiang Ding, a Principal Regulatory and Rates Specialist for PECO, prepared a class cost of service study (COSS) for the Company to use as a guide in allocating its proposed revenue increase among its customer classes.[1321] In her Direct Testimony, Ms. Ding summarized the manner in which each major category of plant investment and each major category of operating costs were functionalized, classified and allocated.[1322] The largest component of PECO's plant investment and associated fixed costs consists of mains. As Ms. Ding explained, the costs of the Company's mains are part of its distribution function and were classified as capacity-related. PECO MB at 97.

[1319] PECO St. 1-R at 10.
[1320] Tr. 225-226.
[1321] Ms. Ding submitted Direct Testimony (PECO St. 6) and accompanying exhibits (PECO Ex. JD-1 through JD-6) and Rebuttal Testimony (PECO St. 6-R) and accompanying exhibits (PECO Ex. JD-1R through JD-8R).
[1322] PECO St. 6, pp. 12-23.

While a portion of the cost of the Company's mains (approximately 1%) was directly assigned, the balance of the cost of mains was allocated using the Average and Excess Demand (A&E) method as described in the treatise *Gas Rate Fundamentals* published by the American Gas Association (1987 edition).[1323] This is the same method PECO used in its last gas base rate case at Docket No. R-2010-2161592. Under the A&E method, the portion of the cost of mains equal to the system average load factor is allocated among the rate classes based on their average daily deliveries (annual deliveries divided by 365 days). The balance of mains costs is allocated based on excess demand, which is the amount by which the design peak demand exceeds average demand for each class. The excess demand is allocated among rate classes in proportion to each class' peak demand over its average demand.[1324] PECO MB at 98.

After the Company submitted its supporting data in this case, it uncovered a formula error in the model used to develop its COSS. Specifically, the revenue increase needed for each rate class to achieve its cost of service should have been calculated to produce the system average rate of return.[1325] Because of the formula error in the COSS, that did not occur. This error resulted in the COSS incorrectly calculating the class revenue increases needed to achieve each class' revenue requirement. Most notably, the revenue increase needed for Rate GR to match its revenue requirement was understated by approximately $24.1 million (i.e., $47.1 million rather than the correct figure of $71.2 million).[1326] PECO MB at 98.

PECO prepared a revised and corrected COSS that the Company provided to all parties in its responses to the OSBA's Interrogatories (Set I) Nos. 1 and 2, which was also submitted by Ms. Ding as PECO Exhibit JD-7R accompanying her Rebuttal Testimony. In addition to correcting the formula error described above, Ms. Ding made four other revisions to the COSS to correct other relatively small errors she had identified and to update the revenue requirement data to reflect changes in the revenue requirement calculation between PECO's

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1323 *Id*. at 13-14.

1324 *Id*.

1325 This formula error related only to equalized proposed rate of return at the proposed class revenue requirement. The cost allocation methodology employed in the model was unaffected and the calculation of class rate of return at present rates was largely unaffected.

1326 PECO St. 6-R, p. 3.

initial filing and its rebuttal case.[1327] The Company's revised COSS was used by PECO witness Joseph A. Bisti to develop a revised revenue allocation as part of the Company's rebuttal case, as explained in PECO Statement No. 7-R. PECO MB at 98-99.

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

Because of the magnitude of the cost of mains, other parties that addressed cost of service focused principally on the allocation of those costs. I&E witness Cline accepted and adopted the methodology and results of PECO's revised COSS. PAIEUG witness LaConte explained that she believed a portion of the total cost of mains was related to the number of customers because a distribution system must be designed to connect to all of a gas utility's customers. However, she acknowledged the practical impediments – lack of sufficient data – to identifying and quantifying the customer-cost component needed for a customer-based allocation. Accordingly, Ms. LaConte accepted the results of PECO's revised COSS as an appropriate guide for allocating the revenue increase in this case. PECO MB at 99.

OSBA witness Robert D. Knecht, like Ms. LaConte, contended that a theoretically correct allocation of mains costs should recognize a customer component. However, he acknowledged Commission precedent rejecting any customer-based allocation of mains costs for gas utilities. Mr. Knecht also disagreed with the theoretical underpinnings of the A&E method because "mains costs are not causally related to average use." Accordingly, Mr. Knecht would have preferred to use a methodology that allocates a portion of mains costs using a customer component and allocates the balance of such costs using a "peak demand allocator."[1328] PECO MB at 99.

Despite his theoretical opposition to the A&E method, Mr. Knecht acquiesced to the weight of relevant Commission precedent that adopted and approved the use of the A&E method in litigated base rate cases for PPL Gas Utilities Corporation and the Philadelphia Gas

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[1327] *Id*. at 4-5.
[1328] OSBA St. 1, pp. 21-23.

Works decided in 2007.[1329] For the same reason, Mr. Knecht, seeking to remain consistent with his perception of prior Commission decisions, proposed weighting the "average" demand and "excess" demand components of the A&E method equally (50% each) in lieu of weighting those elements based on PECO's system load factor (25.23% average demand/74.77% excess demand). Thus, despite his position that average demand should not be reflected at all in the allocation of mains costs, Mr. Knecht subordinated his theoretical opposition to recognizing average demand to his interpretation of prior Commission precedent[1330] and, therefore, proposed a 50% weighting of average demand instead of the lower weighting PECO used in its COSS:

> Consistent with Commission precedent, I accepted the Company's use of an A&E allocation factor. However, while I disagree that mains costs are causally related to average demands, I modified the Company's A&E allocation factor to implicitly include an average demand component. In particular, I modified the A&E allocator to be consistent with the Commission-approved practice at the Philadelphia Gas Works ("PGW"), wherein the average and excess components are weighted at 50 percent.[1331]

PECO MB at 100.

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

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[1329] *Pa. Pub. Util. Comm'n v. PPL Gas Util. Corp.*, Docket No. R-00061398 (Feb. 8, 2007); *Pa. Pub. Util. Comm'n v. Phila. Gas Works*, Docket No. R-00061931 (Sept. 28, 2007).

[1330] Mr. Knecht acknowledged that the Commission approved a 40% average demand and 60% excess demand weighting in *Pa. Pub. Util. Comm'n v. PPL Gas Util. Corp.*, *supra*, but asserted that those figures were "not based on system load factor" (OSBA St. 1, p. 23). While Mr. Knecht claims he has inside knowledge of how those figures were developed, the Commission's Order clearly summaries the record evidence, as follows: "PPL Gas stated that the 40% for commodity [average demand] was based upon system average load factors for 2004 and 2005 of 39.1% and 39.8% respectively. (PPL Gas St. 8-R at 4).").

[1331] OSBA St. 1, p. 24.

way to zero as Mr. Knecht would prefer) is actually closer to the allocation methodology Mr. Knecht advocates as theoretically correct based on cost-causation principles. PECO MB at 101.

OCA witness Watkins was the only witness that opposed using the A&E method to allocate the cost of mains, advocating instead the Peak and Average Demand method (P&A).[1332] The A&E method allocates mains costs based in part on average demand and in part on the portion of peak demand that exceeds average demand. In contrast, the P&A method allocates mains costs based in part on average demand and in part on each class' total peak demand (not just the portion that exceeds average demand). As a consequence, the P&A method implicitly double-counts average demand – once in the "average" demand component and a second time as part of the composition of total peak demand (which includes average demand).[1333] This double-counting creates an unacceptable bias in favor of low-load factor customers who are major contributors to peak demands that drive the cost of mains. PECO MB at 101.

PECO asserts that Mr. Watkins ignored the Commission's acceptance of the A&E method in *Pa. Pub. Util. Comm'n v. PPL Gas Util. Corp.* and *Pa. Pub. Util. Comm'n v. Phila. Gas Works*, opting, instead, to rely upon the Recommended Decision in *Columbia Gas*.[1334] Since Mr. Watkins submitted his Direct Testimony, the Commission has entered a final order in Columbia's case adopting the Administrative Law Judge's recommendation on cost of service allocation. However, Mr. Watkins' characterization of that case is flawed and incomplete, and the Commission's holding is not an endorsement of the use of the P&A method. Rather, the Commission was forced to choose one COSS from those that had been developed in the record, which did not include a COSS using the A&E method. PECO MB at 102.

Columbia submitted three COSSs. The first allocated a portion of mains costs based on a customer component and the balance based solely on peak demand. The second used the P&A method and a 50%/50% weighting of average and peak demand. The third, which

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1332 OCA St. 4, 9-10, 21-23.

1333 PECO St. 6-R, p. 7; PAIEUG St. 1-R, p. 8.

1334 *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa., Inc.*, R-2020-3018835 (Recommended Decision issued Dec. 4, 2020), p. 12.

Columbia promoted, was an “average” of the first two methods. No party supported Columbia’s preferred “average” COSS, and I&E affirmatively and strenuously opposed it. But, because I&E did not conduct its own COSS, it chose the least-bad alternative, which was the P&A-based COSS that Columbia presented, but did not rely upon. OSBA witness Knecht advocated the use of the A&E method, but also did not perform or present his own COSS. In its final order, the Commission accepted the only COSS approach left standing after Columbia’s customer/demand and “average” COSS alternatives were rejected as facially contrary to well-established precedent disapproving customer-based allocations of any part of the cost of gas utility mains. However, in so doing, the Commission clearly signaled that its decision to rely on the P&A COSS in Columbia’s case was not a rejection of the A&E method that it had previously approved in the PPL Gas Utilities and Philadelphia Gas Works cases: “Based on our review of the Orders proffered by the Parties, regarding the OSBA’s position, we find that the Average & Excess is of no significance here in that none of the Parties have submitted this type of methodology for our consideration.” In short, there was no head-to-head contest between the P&A method and the A&E method in the Columbia case. The most that can be said of the PUC’s decision is that, absent a properly developed COSS using the A&E method, the Commission was forced to choose the “second best,” which happened to be the P&A-based COSS. PECO MB at 102-103.

OCA witness Watkins also criticized PECO’s application of the A&E method, claiming that Ms. Ding departed from the rules established by *Gas Rate Fundamentals* because no “excess” demand was allocated to interruptible rate classes.[1335] Mr. Watkins’ reading of the instructions for the A&E method in *Gas Rate Fundamentals* is not correct. The treatise states that an analyst should have discretion to determine how much excess demand costs should be allocated to interruptible customers. This is not surprising, since the extent of such an allocation of excess demand is inextricably tied to how a gas utility designs and constructs its system. As Ms. Ding explained, PECO designs and sizes its capacity to reflect design peak day conditions that assume – correctly – that interruptible customer will not be contributing to peak demand at the time of the design day peak.[1336] Moreover, Mr. Watkins himself conceded the theoretical correctness of Ms. Ding’s approach because, in applying the P&A method, he also did not

[1335] OCA St. 4, p. 18.
[1336] PECO St. 6-R, pp. 8, 24-25.

allocate peak demand costs to interruptible customers in order to recognize that "Interruptible service is inferior to Firm natural gas service."[1337] PECO MB at 103.

iii. Other Cost of Service Issues

1. OCA Witness Watkins – Forfeited Discounts/Non-Base Rate Revenues

OCA witness Watkins alleged that Ms. Ding did not "appropriately reflect non-base rate revenues nor the additional forfeited discount revenues that will be generated as a result of the Company's proposed overall increase."[1338] As explained by Ms. Ding, Mr. Watkins misinterpreted the data presented in PECO's exhibits developing its base rate revenue requirement and, therefore, erroneously concluded that PECO had not properly reflected forfeited discount revenue and non-base rate revenue in calculating its proposed increases. PECO properly credited all of those amounts in developing its proposed increase.[1339] In his surrebuttal testimony, Mr. Watkins did not address, and appears to have accepted, Ms. Ding's explanation that $1,528,000 of what Mr. Watkins refers to as "non-base rate revenue" and the Company identified as "Other Operating Revenue" has been properly reflected in the development of the Company's proposed increase. Mr. Watkins addressed, and continues to disagree with, Ms. Ding's explanation that forfeited discounts, which total $88,000, were not properly reflected (i.e., used to reduce the revenue increase). As Ms. Ding explained in her rebuttal testimony,[1340] a proper apples-to-apples comparison of base distribution revenues provides arithmetic proof that the proposed increase credits the $88,000 of forfeited discounts to the benefit of customers. PECO MB at 104.

Mr. Watkins also disagreed with PECO's allocation of the cost of gas storage plant.[1341] These costs reflect PECO's investment in LNG facilities used to meet design day peaks and other short-term needs of firm sales customers and, accordingly, have been

1337 OCA St. 4, pp. 21-22.
1338 OCA St. 4, p. 20.
1339 PECO St. 6-R, pp. 12-14.
1340 PECO St. 6-R, pp. 13-14
1341 OCA St. 4, p. 22.

functionalized to "storage," classified to demand and allocated among rate classes based on design peak-day send-out.[1342] Mr. Watkins contended that storage plant should be allocated based on the storage allocator Ms. Ding used to assign natural gas storage expenses in PECO Ex. JD-6. PECO MB at 104-105.

OCA witness Watkin's alternative allocation is incorrect because storage plant is used to meet design peak day and short-term needs of firm sales customers. Using the allocator Mr. Watkins proposes would improperly assign storage costs to interruptible customers under rate classes such as Rate TS-I. Notably, all transportation customers already incur additional costs if they do not balance deliveries within 10% of their daily usage as provided in PECO's Retail Gas Tariff. *Id*. at 12.[1343] Moreover, as Ms. Ding also explained, the impact of changing this allocator is immaterial to any and all customer classes in the overall allocation of cost of service. Nonetheless, Mr. Watkins' proposed change is incorrect and should be rejected. PECO MB at 105.

2. OSBA Witness Knecht

Rate GR and GC Design Day Peak Demand. Based on his observation that the design day load factors for Rate GR and Rate GC customers are allegedly "virtually identical," Mr. Knecht assumed that the Company "has not made any independent evaluation of the load patterns of the various rate classes, but simply split the Small Firm design day demands between residential and all other based on volumes." In an attempt to address what he viewed as a deficiency in the Company's analysis of class-specific demands, Mr. Knecht tried to develop "design day demand load factors using a statistical analysis of monthly class loads and heating degree days" which he then "applied design day conditions to the statistical analysis."[1344] The results of his analysis are shown in the table at page 28 of his direct testimony. As evidenced by those data, the differences between the design day load factors used by PECO and those Mr. Knecht proposed to use (in the column RDK GCOSS) are not material for Rate GR (20.9%

1342 PECO St. 6-R, p. 11.
1343 *See also* PECO Energy Company Gas Service Tariff, Sixth Revised Page No. 67, section 2.4.
1344 OSBA St. 1, p. 28.

versus 20.1%) and Rate GC (20.9% versus 22.5%). In fact, Mr. Knecht conceded the point: "As shown, the load factor for the GC class is modestly higher than that for the GR class based on my analysis of actual weather sensitivity."[1345] And, when those data were run through the entire COSS calculation, they yielded – along with other changes Mr. Knecht proposed – no change in the class rate of return at existing rates for Rate GR and only a 0.8 percentage point change for Rate GC.[1346] Mr. Knecht conceded this point as well, noting: "My changes have only modest impacts on allocated costs for the major firm service classes, namely GR, GC and TS-F."[1347] PECO MB at 105-106.

Despite the amount of attention Mr. Knecht gave to this issue, in the final analysis, its impact on Rates GR and GC – the presumptive basis for Mr. Knecht to embark on his alterative analysis – is inconsequential from a practical cost-of-service and rate design standpoint, as Mr. Knecht acknowledged. Nonetheless, PECO disagrees with the premise that prompted Mr. Knecht's alternative analysis. The Company performed a reasonable analysis of the various rate classes as the basis for segregating "small firm" design-day demand among its firm service classes.[1348] Tellingly, except for Mr. Knecht's largely academic exercise, which produced immaterial differences, no other party's expert found PECO's approach insufficiently rigorous to yield design day demand data that are well within the limits of precision generally accepted for use in performing a COSS. Mr. Knecht's criticisms should be disregarded and PECO's revised COSS should be adopted for use as a guide in allocating the revenue increase in this case. PECO MB at 106.

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

> Rate L – Large High Load Factor Service is available to provide firm sales service to large, high load factor customers. Currently, there are four customers that employ Rate L in this capacity as their primary form of service. Rate L also serves another function

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1345 *Id.*
1346 *Id*. at 34, Table IEc-3.
1347 *Id*., p. 35.
1348 PECO St. 6-R, p. 19.

> for the Company and its customers. With the prior approval of the Commission (reaffirmed in numerous subsequent base rate cases up to the present), the Company made Rate L available to customers on Rate TS-F – Gas Transportation Service-Firm as Standby Sales Service. As Standby Sales Service, Rate L serves two purposes.
>
> First, if a Rate TS-F customer's transportation supply cannot be delivered to PECO's city gate (either because of a gas supply shortage or because the interstate pipelines transporting the customer's gas do not have sufficient capacity), the customer can purchase gas from PECO under Rate L as Standby Sales Service.
>
> Second, by engaging PECO to provide Standby Sales Service, a Rate TS-F customer is able to preserve its right to return to traditional sales service. In this way, if a Rate TS-F customer desires to discontinue transportation service, it can seamlessly and automatically resume purchases from PECO under Rate L as its primary form of service. A Rate TS-F customer that does not engage PECO to obtain Standby Sales Service runs some risk that PECO may not be immediately able to resume sales service if a shortage of gas supply or interstate pipeline capacity should arise.
>
> As indicated in the rebuttal testimony of Mr. Richard A. Schlesinger (PECO Statement No. 8-R, page 6), Rate L has been available as Standby Sales Service for many years, and a number of Rate TS-F customers obtain Rate L Standby Sales Service. Those customers understand the purpose Rate L serves, are familiar with its operation and its relationship to their transportation service, and they have come to rely upon Rate L in its existing form for their Standby Sales Service.[1349]

PECO MB at 106-107.

Mr. Knecht expressed two concerns relating to Rates L and TS-F and their relationship to each other. First, Mr. Knecht alleged that PECO had not include design day demands for "pure" Rate L customers (i.e., those that do not use Rate L for Standby Sales Service). Ms. Ding explained how PECO developed the design day demand, which includes the demand of "pure" Rate L customers.[1350] In addition, Ms. Ding explained that Mr. Knecht was expressing concern about an issue that does not have a material impact on design day demand or

1349 PECO St. 6-R, pp. 15-16.
1350 PECO St. 6-R, p. 17.

usage, which is verified by the quantitative analysis Ms. Ding performed in her Rebuttal Testimony (p. 17). While Mr. Knecht did not accept Ms. Ding's explanation that "pure" Rate L demand had been properly recognized by PECO, he conceded Ms. Ding's point that this issue is academic and has no practical effect on the COSS results and adopted the Company's design day demands for Rate L.[1351] PECO MB at 107-108.

Mr. Knecht's second concern takes issue with the long-standing Commission-approved relationship between Rate L and Rate TS-F for transportation customers served on Rate TS-F that voluntarily elect to obtain Standby Sales Service from PECO. Mr. Knecht contended that allowing a Rate TS-F customer to choose Standby Sale Services under Rate L "requires the customer to pay a transportation rate for backup utility supplies from a different rate class" because, according to Mr. Knecht, TS-F customers who choose to obtain Standby Sale Service under Rate L "must deliver that gas at a different rate than if their own gas supplier had provided the gas."[1352] PECO MB at 108.

To address his concern, Mr. Knecht recommended removing the demands associated with Standby Sales Service from the Rate L class and, instead, combining those sales-service demands with the demands of customers receiving only transportation service under Rate TS-F. Mr. Knecht claims that including Standby Sales Service demands with the rest of the sales-service demand the Company serves under Rate L produces an "unusually low load factor" for Rate L overall because "the demands for the standby [sales] load come with relatively little volume." PECO MB at 108-109.

Mr. Knecht's proposal to remove Standby Sales Service demands from the Rate L class and combine them with the transportation-based demands of the Rate TS-F class blurs the distinction between sales service and transportation service. That distinction lies at the heart of the long-standing relationship between Rate L, as Standby Sales Service, and firm transportation service under Rate TS-F, which the Commission has approved in numerous prior base rate cases over many years. It is also a relationship between Rate L and Rate TS-F that PECO's customers

1351 OSBA St. 1-S, p. 9.
1352 OSBA St. 1, pp. 26-27.

understand, accept, and rely upon. Standby Sale Service under Rate L is voluntary – Rate TS-F customers can choose that service or not. To a significant extent, customers have expressed their preference to continue the existing relationship between Rate L as Standby Sales Service and Rate TS-F transportation service by electing to receive Standby Sales Service.[1353] PECO MB at 109.

Mr. Knecht tries to justify blurring the distinction between sales service and transportation service based solely on his observation that keeping all of the sales service demands ("pure" Rate L and Standby Sales Service demands) within the Rate L classification produces an "unusually low load factor." However, assigning sales demands to transportation service simply to raise the load factor of Rate L is a result-oriented approach to demand classification that, contrary to Mr. Knecht's contentions, misrepresents each class' costs. Mr. Knecht's recommendation should, therefore, be rejected. PECO MB at 109.

Rates TS-F Design Day Demand. Mr. Knecht observed that the Company obtained the design day demand of 68,000 mcf/day for Rate TS-F from its PGC filing and noted that it does not appear the Company adjusted that figure to remove demands related to customers served by directly-assigned meters, as it did for the Rate TS-F total through-out volumes.[1354] The Company agreed that the design day demand should have been reduced by the demand relating to one customer served with directly-assigned meters and made that change in the revised COSS submitted with Ms. Ding's Rebuttal Testimony. The impact on the resulting allocation factors used in the revised COSS was not material, as shown by the data provided in Table 3 of PECO Statement No. 6-R at page 23. PECO MB at 109-110.

Rates TS-F and TS-I Annual Volumes Rate Differential. Mr. Knecht contended that the Rates TS-F and TS-I have an unacceptably large differential in the volumetric charges for customers with annual gas consumption capability of at least 18 mmcf and annual gas consumption capability of less than 18 mmcf. Mr. Knecht observed that these rate classes represent a "not-insignificant amount" of base rate revenues (approximately 7%) and contended

[1353] PECO St. 6-R, pp. 21-22.
[1354] OSBA St. 1, p. 27.

that there was not apparent cost allocation justification for the rate differential.   Mr. Knecht made two recommendations for addressing his concerns. From a customer classification standpoint, he recommended creating separate "large" (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 18,000 mmcf and less than18 mmcf reflected in the existing Rate Schedule TS-F and TS-I. PECO MB at 110.

PECO strongly opposed creating separate rate classification for customers with annual gas consumption capability below 18 mmcf and at least 18 mmcf. As Ms. Ding explained, a number of factors other than usage alone must be considered in establishing separate rate classifications. PECO St. 6-R, pp. 23-24. A proper consideration of all of those factors does not support the creation of the separate, usage-based classifications Mr. Knecht recommended. However, PECO did accept Mr. Knecht's alternative recommendation to narrow the differential in the volumetric charges for 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 and PECO Ex. JAB-4 Revised (Corrected)). PECO MB at 110-111.

Interruptible Rate Classes – MV-I, IS and TCS. In his Direct Testimony, Mr. Knecht contended that customers served under interruptible Rates MV-I, IS and TCS do not offer any material distribution service benefits because, for Rate MV-I, there has been no interruption for at least five years and the Rate TCS class has been interrupted only once in the past five years. Mr. Knecht also contended that Rate IS service is interruptible for gas supply reasons, not because it produces distribution system benefits. For these reasons, Mr. Knecht's cost-of-service study assigned design day demands, and associated demand costs, to the MV-I, IS, and TCS rate classes. PECO MB at 111.

PECO opposed Mr. Knecht's proposal because he fundamentally misunderstood the benefits of the ability to interrupt these customers if a design day peak were to be reached on PECO's system. PECO's system is designed to operate at a design day without these customers being on-line (i.e., PECO doesn't incur the costs to size its system to meet the demands of these customers at the time of a design day peak). Assigning peak day demands to these classes, therefore, imposes costs on these customers for a level of service they will not receive and do not expect to receive. In his Surrebuttal Testimony, Mr. Knecht, while not necessarily agreeing with PECO's explanation of the theoretically basis for its COSS approach, agreed that these classes should not be assigned demand costs.[1355] PECO MB at 111.

b. Revenue Allocation

The Company's proposed revenue allocation is based primarily upon four factors: (1) the results of the Company's COSS; (2) moving all rate classes closer to the cost of service indicated by the COSS; (3) adjusting certain class distribution revenues based on proposed changes to PECO's GPC and MFC uncollectible write-off factors; and (4) customer impacts. The Company also considered its obligation under the Commission-approved Joint Petition for Settlement of PECO's 2008 gas base rate case at Docket No. R-2008-2028934 ("2008 Settlement") to eliminate the remaining difference between the system average rate of return and the class rates of return for Rate GC and Rate L. In weighing that commitment against the ratemaking principle of gradualism, the Company initially proposed to more closely align the class rates of return for Rate GC and Rate L with the proposed system average rate of return, without completely eliminating the remaining difference, while limiting the degree to which rates for other classes diverged from their indicated cost of service.[1356] The Company's initial revenue allocation proposal was presented by Mr. Bisti and is set forth in PECO Exhibit JAB-1. PECO MB at 112.

[1355] OSBA St. 1-S, p. 10.
[1356] PECO St. 7, pp. 3-5, 10-11.

i. PECO's Revised Revenue Allocation

The development of a revised COSS necessitated updates to the Company's proposed revenue allocation. The Company developed a revised revenue allocation proposal, which is set forth in PECO Ex. JAB-1 Revised (Corrected). The Company's revised revenue proposal also completely eliminated the remaining difference between the system average rate of return and the class rates of return for Rate GC and Rate L as required under the terms of the 2008 Settlement.[1357] PECO MB at 112.

ii. Opposing Party Alternative Revenue Allocations

I&E witness Cline, PAIEUG witness LaConte, and OSBA witness Knecht proposed alternatives to the Company's revised revenue allocation. Mr. Cline asserted that PECO's revised revenue allocation is not reasonable because (1) the proposed increase for Rate L is excessive and inequitable in light of PECO's recommendation to decrease rates for other classes, and the Rate L increase should be limited to 2.5 times the system average increase of 17.5%; and (2) I&E's alternative revenue allocation proposals for Rate TS-I and Rate TS-F will move the relative rate of return to or closer to 1.0.[1358] PECO MB at 113.

Ms. LaConte contended that the Company's proposed revenue allocation is unreasonable since Rate TS-F will not move closer to cost. Ms. LaConte stated that this will result in firm transportation customers providing higher subsidies, which will be greater for customers taking service on tariff rates than those receiving negotiated rates. Ms. LaConte proposed an alternative revenue allocation that would move all rate classes closer to cost while limiting all increases to 1.5 times the system average, except for Rate GC and Rate L, which Ms. LaConte moved to cost.[1359] PECO MB at 113.

1357 PECO St. 7-R, pp. 2-5; PECO Ex. JAB-1 Revised (Corrected).
1358 I&E St. 3-SR, pp. 17-21.
1359 PAIEUG St. 1-S, pp. 2-6.

Mr. Knecht agreed with PECO's proposed revenue allocation to Rate GC, but recommended that no rate decrease be assigned at the full revenue requirement to reflect gradualism and COVID-19 considerations. Mr. Knecht also agreed with PECO's proposed allocation to Rate L, if the Commission accepts the Company's proposal to retain Rate L as a bundled standby service rate class. However, Mr. Knecht stated that the Company did not provide proper support for its proposed allocations to Rate IS, Rate MV-I, Rate TCS, and Rate TS-F. Mr. Knecht provided alternative allocations to these rate classes.[1360] PECO MB at 113.

Ultimately, as PECO witness Bisti observed, "[t]here are many ways to allocate the increase [i.e., the proposed revenue allocation] that purport to give due consideration to cost of service and the principle of gradualism, as illustrated by the various proposals advanced in this case."[1361] However, the Company's proposal is reasonable as it was calculated utilizing the Company's COSS, moves all rate classes closer to the cost of service indicated by the COSS, eliminates the remaining difference between the class rates of return for Rates GC and L and the system average rate of return, and properly considers customer impacts, including gradualism. The Company's proposal is also substantially within the range of alternative proposals raised by the other parties. Therefore, the Commission should approve the Company's proposed revenue allocation. PECO MB at 114.

iii. Scale Back of Rates

Subject to the specific differences discussed below, the parties are in general agreement with the Company about the scale back that should occur if the Commission grants less than PECO's requested revenue increase. PECO MB at 114.

I&E witness Cline recommended excluding, from any scale back of rates, rate classes that receive no increase or receive a rate decrease from any scale back of rates. He also recommended that the residential customer charge be included in any proportional scale back of

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1360 OSBA St. 1-S, pp. 10-14.
1361 PECO St. 7-R, p. 5.

rates.[1362] OCA witness Watkins recommended excluding Rates GC, OL, MV-I, and TCS from an otherwise proportional scale back of rates.[1363] OSBA witness Knecht expressed concern that a proportional scale back would lead to an inequitable result in the event this proceeding resulted in a significant reduction in the Company's claimed revenue requirement. Mr. Knecht recommended that the Commission adopt a "hybrid approach to a scaleback," in which the rate reduction would be scaled back partly based on the proportional scale back method, and half based on current rate revenues.[1364] PECO MB at 114-115.

The Company believes that a proportional scale back is the most reasonable approach, as it would maintain the relative rate increases among rate classes. In addition, the Company's proposed customer charges should not be subject to any scale back. PECO maintains that 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. PECO MB at 115.

c. Allocation of Universal Service Program Costs

Universal service costs are currently allocated to the residential customer class, and PECO did not propose any change to the allocation of such costs in this proceeding. *See* PECO Exhibit JAB-2. Both OCA witness Colton and CAUSE-PA witness Miller recommended that the Company allocate universal service costs to all customer classes,[1365] while OSBA witness Knecht and PAIEUG witness LaConte opposed that recommendation,[1366] PECO believes this gas distribution base rate case is not the appropriate place to consider broad universal service cost allocation proposals, particularly when, as explained earlier, PECO's gas-only CAP population is an exceedingly small part of its total CAP population. Furthermore, in *Columbia Gas* (pp. 258-261), the Commission recently rejected proposals to reallocate universal service

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1362 I&E St. 3, p. 37; I&E St. 3-SR, pp. 13-14, 25-26.
1363 OCA St. 4, p. 29.
1364 OSBA St. 1-R, pp. 15-20.
1365 *See, e.g.*, OCA St. 5, pp. 56-90; CAUSE-PA St. 1, pp. 48-54.
1366 *See* OSBA St. 1-R, pp. 21-30; PAIEUG St. 1-R, pp. 10-13.

costs to non-residential gas customers. The Company does not support a change in universal service cost allocation as part of this proceeding but, as Ms. Colarelli explained, intends to address the allocation of universal service costs in its next electric base rate proceeding.[1367] PECO MB at 115; PECO RB at 74.

d. Tariff Structure

i. Residential Customer Charge

The Company's current residential customer charge is $11.75 per month and has been in place since rates went into effect following the Company's 2010 gas base rate case. This is the lowest residential customer charge among all of Pennsylvania's major gas distribution companies and is far below the residential customer-related costs identified in the Company's COSS prepared in connection with this rate case (i.e., $30.26 per month). The Company proposed to increase the residential customer charge to $16.00 per month.[1368] PECO MB at 116.

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

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1367 *See* PECO St. 10-R, p. 12.

1368 PECO St. 7, pp. 12-14; PECO St. 7-R, p. 6; *see also* PECO Ex. JD-4R, p. 4.

inappropriate intra-class subsidies or resulting in the Company under- or over-recovering due to variations in customer usage.[1369] PECO MB at 116.

PECO maintains that the Company's proposed $16.00 residential customer charge would still fall within the range of the residential customer charges of the other major gas distribution companies in Pennsylvania and remains below the residential customer-classified costs identified in the Company's COSS.[1370] PECO MB at 116-117.

The OCA opposes any increase in the Company's fixed customer charge for residential gas customers. In the alternative, if the Commission does grant a rate increase, the OCA recommended that, the residential charge increase should be limited to $13.00. In support of these recommendations, OCA witnesses Watkins and Colton claimed that PECO's proposed increase to the customer charge violates the principle of gradualism, is contrary to the goal of promoting energy conservation, and would disproportionately impact low-income customers, particularly because the Company's CAP and federal assistance (LIHEAP) will not sufficiently mitigate the impacts of the increase.[1371] PECO MB at 117.

PECO argues that the Commission should reject Mr. Watkins's proposal to deny the Company's proposed increase to its residential customer charge due to the financial impacts of the COVID-19 pandemic. As the Commission recently noted in its decision in *Columbia Gas*, "the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards ."[1372] Traditional ratemaking methodology dictates that a utility should be permitted to recover fixed customer class-related charges through fixed customer charges. While Mr. Watkins maintains that the Company's residential customer charge should be capped at $13.00, an approximately 10% increase, OCA has not provided any evidentiary support as to why a $13.00/10% cap is appropriate. The Company's proposed residential customer charge

[1369] PECO St. 7, pp. 13-14.
[1370] *Id.*
[1371] OCA St. 4, pp. 30-31; OCA St. 5, pp. 29-32, 55; OCA St. 5-SR, pp. 4-6.
[1372] *Columbia Gas*, p. 42.

should not constitute "rate shock," as it still falls below the residential class' customer-related costs, and would be within a reasonable range of the residential customer charges of other major Pennsylvania gas utilities. Mr. Watkins also failed to properly support his contention that increasing the Company's customer charge is contrary to energy conservation. Denying PECO the ability to move its residential customer charge closer to the residential class-related customer costs identified in the COSS would be unreasonable. PECO MB at 117-118; PECO RB at 76.

Furthermore, while Mr. Colton contends that the Company's proposal will disproportionately impact low-usage, low-income customers, Mr. Colton fails to acknowledge that the Company's proposal to increase the residential customer charge will provide a relative benefit to high-use, low-income customers by lessening the impact of the overall rate increase. The Company believes that its proposal to provide a relative benefit to high-usage, low-income customers, who are more likely to experience higher monthly bills, is reasonable. The Company also believes that Mr. Colton's arguments relative to LIHEAP are irrelevant since LIHEAP is a federal program and PECO is not involved in establishing its funding levels.[1373] PECO MB at 118.

Mr. Miller also recommended that the Commission deny the Company's proposed increase to its residential customer charge. Mr. Miller disagreed that the Company's proposed customer charge would be within the range of charges of other natural gas distribution companies since the Company would be imposing the increase in one rate case. In support, he incorrectly claimed that Columbia Gas increased its residential customer charge over a series of rate cases between 2010 and 2018.[1374] Mr. Miller also stated that the increase would undermine the Company's LIURP since a higher fixed fee would reduce the amount of bill reduction attainable through LIURP measures and undermine energy efficiency efforts.[1375] PECO MB at 118-119.

Mr. Miller's recommendation should be rejected for the same reasons set forth in response to Mr. Watkins and Mr. Colton. The Company's proposal is based on traditional

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1373 PECO St. 7-R, p. 10.
1374 CAUSE-PA St. 1-SR, p. 2.
1375 CAUSE-PA St. 1, pp. 41-44; CAUSE-PA St. 1-SR, pp. 2-3.

ratemaking principles and will more closely align residential customer-related costs with the residential customer charge. The Company also notes that Columbia Gas Company's current residential customer charge was established as a settlement in Docket No. R-2012-2321748, which *decreased* the residential customer charge of $18.73 that had been in effect. Columbia's residential customer charge did not increase in subsequent rate cases. Mr. Miller also failed to support his assertions that the Company's proposed increase to its residential customer charge will impair energy efficiency efforts or undermine the Company's LIURP. The increased customer charge will not prevent customers from making improvements in energy efficiency. PECO MB at 119.

For all of the foregoing reasons, the Commissions should grant the Company's proposed increase to its residential customer charge and deny the recommendations made by the OCA and CAUSE-PA. PECO MB at 119.

ii. Non-Residential Customer Rate Design

1. Rate GC Customer Charge

The Company's current Rate GC customer charge is $28.55. The Company initially proposed an increase to this charge,[1376] but revised its position and is now proposing to maintain the Rate GC customer charge at its current rate.[1377] This is consistent with Mr. Knecht's recommendation related to the Company's initial proposal,[1378] and no parties oppose the Company's proposal to keep the Rate GC customer charge at its current rate.[1379] Therefore, PECO submits that the Commission should approve the Company's proposed Rate GC customer charge. PECO MB at 119-120.

1376 *See* PECO St. No. 7, pp. 14-15.
1377 PECO St. 7-R, pp. 14-15; JAB-4 Revised (Corrected).
1378 *See* OSBA St. 1, pp. 48-49.
1379 *See* OSBA St. 1-S, pp. 18-19.

2. Rate GC Declining Block Volumetric Charge Differential

The Company's Rate GC contains a declining block volumetric charge. Mr. Knecht contended that the declining block tariff is not necessary. He recommended that the Company reduce the volumetric charge differential by applying a larger percentage rate increase to the tail block charge.[1380] The Company concluded this proposal is reasonable and incorporated Mr. Knecht's proposed differential into its proposed rate design.[1381] No other parties opposed this proposal. PECO submits that the Commission should approve PECO's proposed Rate GC declining block volumetric differential. PECO MB at 120.

3. Rate TSF and TS-I Volumetric Charge Differential

As previously noted, Mr. Knecht recommended that the Company reduce its Rate TS-F and Rate TS-I volumetric charge differentials and Mr. Bisti adopted Mr. Knecht's proposed differential (subject to further changes to the Company's proposed rates) and incorporated the differentials into its proposed rate design. Mr. Knecht stated that he agreed with the Company's revised proposal for Rate TS-F, but that the proposal set forth in PECO St. 7-R and PECO Ex. JAB-4 Revised did not incorporate Mr. Knecht's proposal regarding Rate TS-I. The Company's acknowledged this oversight and further modified Rate TS-I in PECO Exhibit JAB-4 Revised (Corrected) to fully incorporate Mr. Knecht's recommendation.[1382] PECO MB at 120.

PAIEUG witness LaConte objected to Mr. Knecht's proposal. She alleged that the data provided by Mr. Bisti to determine if the Company's load factor analysis is correct, in response to a PAIEUG discovery request, was not provided in a workable format. Ms. LaConte also contended that the Company's recommended volumetric rate would disproportionately impact large Rate TS-F customers, resulting in large Rate TS-F customers receiving a 56.2% increase in volumetric rates, contrary to the principle of gradualism. Ms. LaConte recommended

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1380 OSBA St. 1, pp. 50-51.
1381 PECO St. 7-R, p. 15.
1382 *See* PECO Ex. JAB-4 Revised (Corrected).

that the Commission reject the Company's proposed Rate TS-F differential and maintain the current Rate TS-F differential.[1383] PECO MB at 120-121.

PECO submits that the Commission should approve the Company's proposed rate design for Rate TS-F and Rate TS-I. The Company incorporated Mr. Knecht's recommendation related to Rate TS-I and no other party has challenged the volumetric differentials presented by the Company. With respect to Rate TS-F, the Company disagrees with Ms. LaConte's representation that the Company failed to provide the requested information related to Rate TS-F in a workable format. In response to Ms. LaConte's request for the Company's workpapers utilized to derive its revised Rate TS-F and TS-I rates, the Company provided (1) corrected versions of the Company's proof of revenues for Rate TS-I and TS-F in Excel format (consistent with PECO Ex. JAB-4 Revised (Corrected)); and (2) the version history of volumetric distribution charges under proposed rates for both classes. No other party challenged the "workability" of these materials. Further, the Company does not believe that its proposal will result in "rate shock" to the large Rate TS-F customers. As acknowledged by Ms. LaConte, the large Rate TS-F customers are large commercial and industrial users that have enjoyed the benefit of no rate increase since new rates went into effect after the Company's 2010 base rate case. Mr. Knecht's recommended approach to minimizing the differential between small and large Rate TS-F customers reflects a reasonable balance in rate design that takes into account the needs of all customers. PECO maintains that the Commission should reject Ms. LaConte's proposal and approve the Company's proposed rate design. PECO MB at 121.

4. 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. 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

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[1383] PAIEUG St. 1-S, pp. 6-8.

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.[1384] 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."[1385] PECO submits that the Commission should reject OSBA's proposal. PECO RB at 79-80.

5. Elimination of Rate IS Margin Sharing

The Company's Rate IS is an interruptible service that is keyed to a customer's cost of alternative fuel. Customers that take service under Rate IS are charged a customer charge plus a rate per Mcf that is (1) no less than PECO's commodity cost of gas for the month plus three cents; and (2) no more than the price, on an equivalent BTU basis, of the alternative fuel the customer is capable of consuming. PECO subtracts, from that price, its weighted average cost of flowing gas. The remainder, which is PECO's gross margin, is divided between PGC customers and shareholders: 75% is credited to purchased gas costs and returned to PGC customers and 25% is retained by the Company.[1386] PECO MB at 122.

OSBA witness Knecht and OCA witness Watkins recommended that the Company eliminate this margin sharing mechanism.[1387] Both witnesses stated that the sharing mechanism is no longer appropriate in the context of a competitive natural gas supply market.[1388] Mr. Knecht also stated that the sharing mechanism results in an improper subsidization of utility gas supply service customers by PECO transportation-only customers and contended that the structure has not been successful in attracting new customers given that there are currently only two Rate IS customers.[1389] PECO MB at 122.

1384 PECO St. 8-R, pp. 5-6.
1385 OSBA St. 1-S, p. 25.
1386 PECO St. 7, pp. 9-10.
1387 *See* OSBA St. 1, pp. 43-44; OCA St. 4, pp. 28-29.
1388 *Id.*
1389 OSBA St. 1, pp. 43-44.

The Company agreed to propose eliminating the disputed Rate IS sharing mechanism on or before December 1, 2021, as part of its next annual PGC reconciliation filing, and updated its revenue requirement, COSS, revenue allocation and proof of revenues to reflect this change. No other party disputed this sharing mechanism. The Company believes this is a reasonable compromise that will enable it to properly phase out the sharing mechanism. The Commission, therefore, should reject the OCA's and OSBA's recommendation to eliminate the Rate IS sharing mechanism as part of this base rate case. PECO MB at 123.

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

Mr. Knecht recommended that the Company eliminate Rate IS, Rate MV-I, and Rate TCS. He primarily asserted that none of these interruptible rates provide any "obvious benefit" to firm base rate customers.[1390] Mr. Knecht also noted there are only two customers that take service under Rate MV-I, natural gas vehicles do not appear to be a "winning technology" that continues to justify its own rate, and that Rates MV-I and TCS are anti-competitive in that they are designed to provide lower-cost delivery service to customers taking service from the Company than customers served by competitive natural gas suppliers. Mr. Knecht also observed that PGW abandoned similar mechanisms. PECO MB at 123.

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

[1390] OSBA St. 1, pp. 43-46.

PGW and unsupported prognostications regarding certain industries are irrelevant.[1391] PECO MB at 123-124.

The Company sees no benefit to eliminating Rate IS, Rate MV-I, or Rate TCS at this time, and upon review, Mr. Knecht acknowledged that any potential negative aspects of retaining these rates are likely to be minimal, and that they can be addressed by the Company over a longer term. Accordingly, the Company submits that the Commission should reject OCA's recommendation to eliminate Rate IS, Rate MV-I and Rate TCS. PECO MB at 124.

iii. Distribution System Improvement Charge (DSIC) Cost Allocation

PECO notes that in his direct testimony, OSBA witness Knecht expressed concerns regarding the allocation of costs to Rate GC customers under PECO's existing DSIC mechanism. According to Mr. Knecht, the Company's allocation of DSIC-eligible costs among rate classes based on volumetric charge revenue does not comport with cost causation principles or the Commission-approved cost allocation method for the DSIC.[1392] Contrary to Mr. Knecht's contention, the Company's DSIC cost allocation methodology is consistent with Act 11 of 2012 and the Commission's Final Implementation Order at Docket No. M-2012-2293611. PECO MB at 124.

As PECO witness Bisti explained in his rebuttal testimony,[1393] PECO's DSIC charges to customers are capped at 5% of the amount billed to customers for distribution service, consistent with Section 1358(a)(1) of the Code,[1394] Commission requirements and the Company's tariff. After reviewing Mr. Bisti's rebuttal testimony, Mr. Knecht conceded that his claim that PECO's DSIC charges to Rate GC customers appear to exceed the 5% statutory cap is incorrect.[1395] Nonetheless, after carefully considering Mr. Knecht's testimony on this issue, the

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[1391] PECO St. 7-R, pp. 16-19.
[1392] *See* OSBA St. 1, pp. 46-48.
[1393] PECO St. 7-R, p. 13
[1394] *See* 66 Pa.C.S. § 1358(a)(1) ("[T]he distribution system improvement charge may not exceed 5% of the amount billed to customers under the applicable rates of the wastewater utility or distribution rates of the electric distribution company, natural gas distribution company or city natural gas distribution operation.").
[1395] OSBA St. 1-S, p. 18.

Company concluded that it would adopt the OSBA's recommendation to modify PECO's budgetary cost allocation procedures to distribute DSIC-eligible costs among the rate classes based on total rate base revenues, including both customer charge and volumetric revenues.[1396] PECO MB at 124-125.

iv. Negotiated Gas Service

The Company's current Commission-approved tariff permits the Company to offer negotiated (i.e., discounted) gas service to customers under specified circumstances pursuant to the Company's Rate NGS. To be eligible for service under Rate NGS, a customer must: (1) either have a history of at least 18,000 Mcf of annual natural gas usage billed by the Company, or, if a new customer, establish that the facilities to be served are likely to consume at least 18,000 Mcf of annual natural gas usage; (2) document a viable, currently available competitive alternative to service under Rates GC, L, TS-F, or TS-I; and (3) execute an NGS agreement that comports will all provisions set forth in Rate NGS.[1397] PECO MB at 125.

Six of the Company's customers currently take service under Rate NGS. I&E, OCA, and OCA contended that PECO did not establish that all of these customers are still eligible to receive service under Rate NGS. PECO MB at 125.

OCA witness Watkins recommended that the Company reevaluate the terms and rates for ***** BEGIN CONFIDENTIAL***** [redacted] *****END CONFIDENTIAL***** including performing an analysis of the customers' ability to use alternative fuels and a supporting financial analysis for proposed negotiated rates on a going-forward basis. Mr. Watkins stated that these findings should be provided to the Commission and OCA on, or before, the Company's next base rate case filing.[1398] In support of his recommendation, Mr. Watkins noted that PECO has been providing service to three of its Rate

1396 PECO St. 7-R, pp. 13-14; PECO Ex. JAB-4 Revised (Corrected).
1397 *See* PECO Ex. JAB-2, pp. 76-77.
1398 OCA St. 4, pp. 32-34.

NGS customers for a significant period and that the Company could not provide the original financial analysis supporting the discounted rate to these customers. PECO MB at 125-126.

I&E witness Cline recommended that the Company, at all future base rate case filings, be required to provide an updated analysis for any Rate NGS customer that has not had its alternative fuel source, or opportunity for pipeline bypass or relocation, as applicable, verified for a period of five years or more, and that the Company cease providing service to any customer under Rate NGS that does not have a verified alternative to Company service. I&E witness Cline also recommended that, in future base rate cases, PECO separate the costs and revenues of customers that take service under discounted or reduced rates in their own class in the Company's COSS.[1399] PECO MB at 126.

OSBA witness Knecht stated that the Company failed to demonstrate the eligibility and reasonableness of rates, under Rate NGS, for ***** BEGIN CONFIDENTIAL***** [redacted]. *****END CONFIDENTIAL***** [1400] PECO MB at 126).

The Company agreed with Mr. Watkins' request and stated it would provide the requested information with its next base rate case filing.[1401] However, the Commission should reject Mr. Cline's and Mr. Knecht's recommendations. With respect to Mr. Cline's recommendation that the Company be required to evaluate Rate NGS customers' alternative fuel sources every five years, the Company's Commission-approved tariff for Rate NGS does not require the Company to re-evaluate customer eligibility for Rate NGS at any specified time, except when a customer initially applies for service. At that time, PECO and its customers generally evaluate the potential benefits of a Rate NGS service agreement over a lengthy period,

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1399 I&E St. 3, pp. 33-36; I&E St. 3-SR, pp. 22-25.
1400 OSBA St. 1, pp. 39-42; OSBA St. 1-R, pp. 13-15; OSBA St. 1-S, pp. 16-17
1401 PECO St. 7-R, p. 23.

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.[1402] While PECO is amendable to providing the analyses requested by Mr. Watkins, the Company believes that requiring it to regularly re-evaluate Rate NGS customers' eligibility, regardless of the Company's contractual terms, will hinder its ability to enter into NGS agreements and potentially increase costs to other customers. PECO MB at 126-127.

The Commission should also reject Mr. Knecht's recommendations. *****BEGIN CONFIDENTIAL***** [redacted]. *****END CONFIDENTIAL***[1403]** In addition, the OSBA's argument (supported by I&E witness Cline in his surrebuttal testimony) that the Commission should require PECO's investors to bear the difference between tariffed rates and the discounted rates provided to Customers 3, 5 and 6 should be rejected. That recommendation would violate shareholders' constitutional right to a fair return on and of their investment. PECO MB at 127-128.

v. Theft/Fraud Investigation

In the Company's existing Tariff, Rule 17.6 establishes reconnection fees for terminations associated with non-payment, as well as fees for investigation and remediation of theft or fraud. PECO originally proposed to separate these two fees into distinct tariff rules, with

1402 PECO St. 7-R, pp. 22-23.
1403 *See* PECO St. 7-R, pp. 19-25.

the new Rule 17.7 including a $460 fee for investigation and remediation of theft or fraud.[1404] The Company later clarified that: (1) proposed Rule 17.7 would only be applied in cases of confirmed active gas theft; (2) the $460 fee was consistent with the average cost to investigate and remediate theft only; and (3) the term "fraud" should be stricken from the proposed rule.[1405] PECO MB at 128.

OCA witness Colton opposed proposed Rule 17.7, expressing concern about (1) the breadth and vagueness of rule language; (2) the application of the rule to "applicants"; and (3) the inclusion of "allocated overheads and administrative costs" in the proposed fee and the potential for double recovery of costs by the Company.[1406] PECO MB at 128.

Mr. Schlesinger addressed each of Mr. Colton's areas of concern. First, Mr. Schlesinger clarified that proposed Rule 17.7 will apply in the case of confirmed active gas theft only and therefore all references to fraud will be stricken from the rule.[1407] He also explained that PECO does not believe it is prudent to provide a specific definition of theft in the Company's tariff because the means by which tampering occurs evolves over time.[1408] PECO MB at 128.

Second, Mr. Schlesinger explained the circumstances under which an "applicant" could be properly assessed a fee under the proposed rule. If, for example, PECO confirms that "Person A" is tampering, the Company would terminate service to that customer and apply the $460 fee under proposed Rule 17.7. "Person A" could then apply for gas service at a different property without paying the $460 fee. Person A is now an "applicant" because he or she is not currently a customer, but the past charges for theft should continue to be applied to Person A at his or her new service address.[1409] PECO MB at 129.

1404 *See* PECO St. 8, pp. 8-9.
1405 *See* PECO St. 8-R, pp. 2-3; Hearing Tr. 202.
1406 *See* OCA St. 5, pp. 109-113; OCA St. 5-SR, pp. 7-9.
1407 *See* PECO St. 8-R, pp. 2-3; Hearing Tr. 202.
1408 *See* PECO St. 8-R, p. 3.
1409 Hearing Tr. 203.

Finally, in response to Mr. Colton's concerns about double-recovery of "allocated overheads and administrative costs," Mr. Schlesinger explained that the Company had made a $10,000 revenue adjustment for "budgeted theft fee revenue" that was based on the actual 2019 gas revenues collected under existing Rule 17.6 related to the investigation and remediation of theft.[1410] For all these reasons, the Company has demonstrated that proposed Rule 17.7 is appropriate and should be approved by the Commission. PECO MB at 129.

e. Summary and Alternatives

PECO submits that its COSS reflects a reasonable balance between the costs incurred by the Company to meet customers' service requirements and the allocation of those costs to customer classes respecting cost causality. PECO's proposed revenue allocation in this case also provides an appropriate balance of the competing interests of the Company's major classes and makes reasonable progress in moving all classes closer to their cost of service consistent with well-accepted ratemaking principles. In addition, PECO has accepted a variety of non-residential rate design proposals recommended by I&E and the OSBA. Accordingly, PECO's proposed rate structure fairly and reasonably allocates the increase in gas revenues among PECO's customer rate classes and should be approved. PECO MB at 129.

2. I&E's Position

a. Cost of Service

i. PECO's Class Cost of Service Study

I&E notes that PECO first provided its COSS with its original filing in PECO Exh. JD-1 through JD-6.[1411] PECO then provided an updated cost-of-service study in response to discovery requests from OSBA.[1412] I&E acknowledges that it based its customer cost analysis

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1410 *See* PECO St. 8-R, p. 3; Hearing Tr. 202.
1411 I&E St. No. 3, p. 26.
1412 *Id.*

on the updated COSS.[1413] The customer cost analysis is a part of the analysis of a COSS that is used to determine the appropriate fixed customer charges for the various classes and meter sizes; and it includes customer costs only.[1414] I&E MB at 65.

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

I&E agrees with using the Average and Excess methodology, as presented by the Company, as a reasonable method to allocate costs and revenues in this proceeding.[1415] I&E notes that the OCA disagreed with I&E's position, noting I&E's support of the Peak and Average allocation methodology in previous rate cases, in support of OCA's objections to the Average and Excess methodology in this case.[1416] I&E MB at 65-66.

The OCA is correct in that I&E has supported the Peak and Average methodology in previous cases.[1417] However, I&E has also supported the Average and Excess methodology when it was presented in other cases.[1418] For example, in the *UGI Penn Natural Gas, Inc*. base rate case at Docket No. R-2016-2580030, I&E did not oppose the use of the Average and Excess methodology.[1419] I&E believes that both COSS methodologies are reasonable solutions when performing a COSS for natural gas utilities.[1420] Similarly, I&E has supported a 50% peak / 50% average mains allocation in previous cases and as recommended by OSBA in this case as well.[1421] However, in this case, I&E determined that the Company's proposed allocation methodology is reasonable.[1422] I&E MB at 66.

In consideration of the Company's rebuttal testimony in addition to the opposing testimony from the other parties above and the record evidence presented, I&E believes the

1413 *See* I&E St. No. 3, pp. 26-37.
1414 *Id.*, p. 26.
1415 I&E St. No. 3-SR, pp. 15-16.
1416 *Id.*, p. 16.
1417 *Id.*
1418 *Id.*
1419 *Id.*
1420 *Id.*
1421 *Id.*
1422 *Id.*

Company's revised COSS is reasonable except for the calculation of the relative rate of return.[1423] I&E MB at 66.

b. Revenue Allocation

i. PECO's Revised Revenue Allocation

The Company revised its proposed revenue allocation in order to conform to its revised COSS and also to eliminate the differences between the system average rates of return for the GC and L rate classes as required under the terms of the 2008 base rate case settlement at Docket No. R-2008-2028934.[1424] PECO's revised revenue allocation is discussed and analyzed by I&E witness Cline in both his direct and surrebuttal testimony.[1425] I&E identified several issues regarding the Company's proposed rate allocation methodology.[1426] I&E MB at 67.

The Company is proposing a 389% increase for the L rate class and approximately 27% increases for the GR and TS-F classes while proposing rate decreases for the remaining classes.[1427] First issue, the 389% rate increase for the L rate class is excessive and violates the concept of gradualism and could result in rate shock for those customers.[1428] Second, I&E agrees with the rebuttal testimony of OCA witness Watkins regarding the fairness of certain rate classes receiving rate increases while other rate classes are receiving rate decreases.[1429] For these two reasons, the Company's proposed revenue allocation is not reasonable and should be rejected.[1430] Ultimately, I&E recommended a revised revenue allocation.. I&E MB at 67; I&E RB at 41.

1423 *Id.*
1424 PECO St. No. 7-R, pp. 4-5.
1425 I&E St. No. 3, pp. 28-33; I&E St. No. 3-SR, pp. 17-21.
1426 I&E St. No. 3-SR, p. 19.
1427 *Id.*
1428 *Id.*
1429 *Id.*
1430 *Id.*

ii. Opposing Party Alternative Revenue Allocations

I&E's proposed revenue allocation is set forth in I&E witness Cline's surrebuttal testimony.[1431] I&E's final proposed revenue allocation was arrived at using the data provided by the Company in PECO Exhibits JD-1R through JD-6R by first creating a schedule that shows the calculation of relative rates of return based on proposed revenue, expenses, taxes, net income and rate base by class.[1432] I&E MB at 68.

Then, based on I&E's proposed revenue allocation schedule and taking into consideration the issues brought forth by the OCA and OSBA, I&E developed its recommended revenue allocation.[1433] It should be noted that while the MV-F class shows a revenue decrease, which is due to the DSIC being set at 0%, the Tax Reform Base Rate Impact, and the GPC reduction, and not due to a reduction in rates.[1434] Additionally, the revenue increases shown in I&E Exh. No. 3-SR, Sch. 4 include adjustments for the GPC and MFC reductions.[1435] I&E MB at 68, I&E RB at 42.

iii. Scale Back of Rates

Under I&E's original revenue allocation, I&E recommended that, if the Commission grants less than the Company's requested revenue increase, then several rate classes receive either no increase or a rate decrease.[1436] Further, because Rate L remained far below its cost to serve, I&E recommended that its increase should not be scaled back.[1437] Therefore, I&E originally recommended that the only rate classes that should receive a scale back, should the Commission grant less than the Company's full requested increase, were the residential, TS-I, and TS-F classes.[1438] I&E MB at 68-69; I&E RB at 42.

1431 I&E St. No. 3-SR, p. 21.
1432 *Id.*, p. 20.
1433 *Id.*, pp. 20-21; I&E Exh. No. 3-SR, Sch. 4.
1434 *Id.*, p. 20.
1435 *Id.*
1436 I&E St. No. 3, p. 37.
1437 *Id.*, p. 37.
1438 *Id.*, p. 37.

I&E, however, revised its proposed scale-back as a result of its revised revenue allocation.[1439] Therefore, in consideration of the record evidence presented, I&E recommends that only the rates of those rate classes that receive an increase be scaled back proportionately based on the COSS ultimately approved by the Commission.[1440] Further, I&E continues to recommend that the customer charges be included in the scale back of rates.[1441] I&E MB at 69; I&E RB at 42-43.

Finally, gradualism is a well-established ratemaking concept that seeks to limit the immediate increases customers receive when rates are increased and instead seeks to implement significant rate changes on a more gradual basis over time. If the Commission should approve a rate increase, then the Commission has the discretion[1442] to apply the concept of gradualism if the Commission determines the rate increase would result in a sudden and excessive increase that would violate the concept of gradualism. For this reason, I&E mentions the concept of gradualism as one of the tools of discretion in the Commissions toolbox. I&E MB at 69; I&E RB at 43.

c. Allocation of Universal Service Program Costs

I&E took no position with regard to the OCA's and CAUSE-PA's recommendation that the Company allocate universal service costs to all customer classes. I&E notes that the Company, OSBA, and PAIEUG oppose the recommendation.

1439 *See* I&E St. No. 3-SR, p. 26.
1440 *Id.*
1441 *Id.*
1442 *See Columbia Gas*, pp. 44-55, Docket No. R-2020- 3018835, Order Entered February 19, 2021 (for a comprehensive discussion of the Commission's discretionary authority).

d. Tariff Structure

i. Residential Customer Charge

While I&E noted that the Company's proposed $16.00 customer charge is supported by the customer cost analysis, the $4.25 increase from $11.75 to $16.00, or 36%, is a significant increase that cannot be ignored.[1443] I&E's analysis included the noted review of the COSS, the customer cost analysis, and the relative rate of return regarding rate allocation.[1444] Therefore, I&E recommended that the customer charge be included in the scale back of rates if the Commission grants less than the full requested increase.[1445] I&E MB at 70.

Further, I&E 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.[1446] I&E continues to argue the Company's proposed customer charge increase from $11.75 to $16.00, or 36%, is a significant increase, and that including the customer charge when rates are scaled back is reasonable.[1447] I&E MB at 70-71; I&E RB at 43-44.

ii. Non-Residential Customer Rate Design

I&E reiterates that any analysis regarding the setting of non-residential customer charges should include a review of the COSS; the customer cost analysis; and the relative rate of return regarding rate allocation.[1448] I&E MB at 71.

1443 I&E St. No. 3, p. 28; I&E St. No. 3-SR, p 13.
1444 *See* I&E St. No. 3, pp. 26-33; I&E St. No. 3-SR, pp. 13-21.
1445 I&E St. No. 3-SR, p. 13.
1446 *Id.*, p. 14.
1447 I&E St. No. 3, p. 28.
1448 *See* I&E St. No. 3, pp. 26-33; I&E St. No. 3-SR, pp. 13-21.

iii. Distribution System Improvement Charge (DSIC) Cost Allocation

Application of the Distribution System Improvement Charge (DSIC) and related cost allocation is governed by the Public Utility Code.[1449] I&E recommends the Commission apply the relevant sections of the Public Utility Code to any proposed DSIC cost allocation. I&E MB at 71.

iv. Negotiated Gas Service

I&E recommended that the Company provide an update to the competitive alternative analysis for any customer that has not had their alternative fuel source verified for a period of 5 years or more at the point at which PECO files a base rate case.[1450] I&E also recommended that the Company cease NGS service to any customer that does not have a verified alternative supply and switch those customers to the appropriate tariffed rate.[1451] Further, I&E recommended that, in future base rate cases, PECO separate the costs and revenues of customers discounted or reduced rates in their own class in the cost of service study.[1452] I&E MB at 71-72.

PECO clarified its discovery response indicating that the Company does not require an alternate fuel source as a competitive alternative, but instead allows for pipeline bypass or relocation to be a viable alternative for customers applying to negotiated rates, asserting this clarification is reasonable and consistent with the policies of other Pennsylvania Gas Utilities that offer negotiated rate service.[1453] The Company also stated that it disagreed with I&E's overall recommendation for periodic updates to the associated competitive analysis.[1454] I&E MB at 72.

Additionally, the OSBA opposed I&E's recommendation regarding the verification of competitive alternatives because it does not address the OSBA claim that the

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1449 *See* 66 Pa. C.S. §§ 1350-1360.
1450 I&E St. No. 3, p. 36.
1451 *Id.*
1452 *Id.*
1453 PECO St. No. 7-R, p. 22.
1454 *Id.*

Company failed to meet the requirements necessary for most of its negotiated rate customers.[1455] I&E agrees with the OSBA in that, if the Commission agrees with the OSBA that the Company has not sufficiently supported the requirements for its negotiated rate customers, then that shortfall in revenues should be borne by PECO's shareholders and not its customers; however, I&E did not address this determination in its direct testimony.[1456] I&E MB at 72.

Finally, I&E reiterates it is important to periodically analyze competitive alternatives to ensure that the rates of flex rate customers are not discounted lower than is necessary to avoid the customer choosing the alternative supply.[1457] Providing excessive discounts to customers would be harmful to both the Company and its customers since the other customers make up the revenue shortfall that results when flex-rate customers pay less than tariff rates.[1458] The rates of non-negotiated customers will always be higher than if the negotiated customers were paying non-discounted rates whether the Company is providing service to those customers or not.[1459] The only safeguard that customers have to protect them from absorbing the costs from excessively discounted rates is the verification of competitive alternatives for the negotiated rate customers.[1460] I&E MB at 72-73.

Therefore, in consideration of the above and the record evidence presented, I&E recommends that the Company provide an update to the competitive alternative analysis for any customer that has not had their alternative fuel source verified for a period of 5 years or more at the point at which PECO files a base rate case.[1461] I&E MB at 73.

v. Theft/Fraud Investigation

I&E did not brief this specific issue.

1455 *See* OSBA St. No. 1-R, pp. 14-15.
1456 I&E St. No. 3-SR, pp. 24-25.
1457 I&E St. No. 3, p. 34.
1458 *Id.*
1459 *Id.*
1460 *Id.*
1461 I&E St. No. 3-SR, p. 25.

e. Summary and Alternatives

I&E's analysis included the noted review of the COSS; the customer cost analysis; and the relative rate of return regarding rate allocation. Further, I&E's proposed monthly customer charge; as well as its gradualism and scale back recommendations, are based on sound Commission ratemaking policies and precedent and should be adopted and implemented in this proceeding. I&E MB at 74.

3. OCA's Position

a. Cost of Service

i. PECO's Class Cost of Service Study

The OCA notes that PECO witness Ding's classification of Mains was of particular importance in this proceeding. As OCA witness Watkins testified, the classification of Mains of a natural gas utility is vitally important to the outcome of a COSS.[1462] In this instance, mains represent 50% of the Company's gross plant.[1463] The OCA further notes that Ms. Ding's COSS and classification of mains was based upon the Average and Excess (A&E) Method. The OCA asserts that Ms. Ding's COSS relies upon the A&E Method to allocate the costs of distribution mains that cannot be directly assigned. OCA MB at 163-164; OCA RB at 81.

After functionalizing, classifying and allocating the costs among rate classes, Ms. Ding then determined what the revenue requirements were for each class to produce the rate of return equal to the Company's proposed overall rate of return in its filing.[1464] Thus, based upon the results of Ms. Ding's COSS, it was determined that the Company should, *inter alia*, increase the annual distribution revenues from the residential customer class by approximately $47

[1462] OCA St. 4 at 5-6.
[1463] OSBA St. 1 at 19.
[1464] PECO St. 6 at 25.

million and the general service customer class by approximately $16.6 million.[1465] OCA MB at 164.

The OCA points out that shortly after filing the COSS, a mathematical error was discovered in Ms. Ding's COSS that greatly impacted the required class rates of return at the Company's proposed overall revenue requirement.[1466] As a result of this error, the revised COSS corrected the underreported revenue increase for Rate GR from $47.1 million under the originally-filed COSS to $71.2 million under the revised COSS.[1467] Ms. Ding also made several other corrections to her COSS in response to the testimony of other expert witnesses.[1468] OCA MB at 164-165.

The OCA disputes the Company's use of the A&E method. The OCA supports the use of the Peak and Average ("P&A") methodology and argues that, contrary to the Company's contentions regarding Commission acceptance of the A&E method, the Commission recently recognized in *Columbia Gas* its long-held practice of adopting the P&A Method for the allocation of costs of distribution mains investment. The OCA notes that, in *Columbia Gas,* the Commission stated:

> Based on our review of the record, and as noted by the ALJ, we have consistently used the Peak & Average methodology for the allocation costs for NGDCs.
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> Furthermore, distribution mains exist and are related to both annual demands and peak demands. Both annual and peak demands must be recognized in the allocation of distribution mains cost if the allocation is to be in accord with the principle of cost-causality. It is not reasonable to allocate distribution mains investment based solely on design peak day demands as in Columbia's Customer-Demand ACCOSS. The basic reason Columbia invests in its distribution system is to meet the annual demands for gas by customers. Additionally, a portion of the total cost of distribution

1465 *See* PECO St. 6, Exh. JD-1, Pg. 3, Line 134.
1466 *See* OCA St. 4 at 19; *see also* PECO St. 6-R at 3.
1467 *Id*.
1468 PECO St. 6-R at 4-5.

service is related to installing a system with enough throughput capacity to meet design peak demands in excess of annual demands.[1469]

The OCA further notes that while the Commission did not have a COSS utilizing an A&E Method before it in *Columbia Gas*, the Commission acknowledged that it has consistently used the P&A Method to allocate distribution mains, which is based on long-standing precedent of this Commission.[1470] OCA RB at 85.

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

The OCA submits that the Commission should dismiss the use of Ms. Ding's proposed A&E Method. As OCA witness Watkins testified, the A&E Method is one method amongst others that is rarely used to determine the classification of mains:

> While a myriad of cost allocation methods and approaches have been developed, three methods predominate in the NGDC industry: "Peak Responsibility," "Peak and Average (P&A)" or "Demand/Commodity," and "Customer/Demand," which I will address shortly in more detail. These methods differ in the criteria used to allocate Mains, as cost allocation analysts do not universally agree on the cost causative factors or drivers influencing Mains investments.
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> ***
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> There is another cost allocation method that is rarely applicable or used in the natural gas industry and is known as the Average & Excess ("A&E") method. The A&E method should not be confused with the P&A method as these two approaches are materially different in concept and application.[1471]

OCA MB at 165-166.

1469 *Columbia Gas* at 215, 217-218.

1470 *See also NFGD 1994*, 1994 Pa. PUC LEXIS 134 at *320-321; *Pa. Pub. Util. Comm'n v. Equitable Gas Co.*, Docket No. R-901595, 1990 Pa. PUC LEXIS 135 at *139-42, 154 (Pa. PUC Nov. 21, 1990), *Pa. Pub. Util. Comm'n v. Peoples Natural Gas Co.*, Docket No. R-880961, 1989 Pa. PUC LEXIS 36 at *80-81 (Pa. PUC Jan. 27, 1989) ("In our opinion, the peak and average method appropriately recognizes both demand (peak) and commodity (average) factors in the allocation of system costs.") (*PNG 1989*).

1471 OCA St. 4 at 7-8.

Mr. Watkins asserted that the A&E method is heavily weighted towards 'excess' use, or the amount by which a class of customers non-coincident peak demand exceeds its average day usage.[1472] Thus, "classes with low load factors (e.g., Residential and Small Commercial) tend to have high levels of this so-called "excess" demand and are assigned the vast majority of the "excess" portion."[1473] Conversely, 'average' use tends to be underrepresented, such that the A&E method gives very little weight to the Industrial class's average day use.[1474] OCA MB at 166.

OCA witness Watkins further testified as to why the A&E Method should not be used when applied to NGDCs and specifically to PECO:

> For public utility industries that are able to produce and store their product within their distribution system such as the water utility industry, the A&E approach has intuitive appeal particularly as it relates to water production and storage facilities. This is because even though a water utility may design its water treatment facilities to meet its maximum peak day demands, this capacity may not be large enough to meet maximum diurnal (hourly) demands. Because a water utility can produce and treat water during off-peak periods and then store water, it can then have enough resources to meet these peak hourly loads. The A&E method (known as the Base Extra Capacity method in the water industry) recognizes class load diversity in that all classes do not peak at the same time and also recognizes that water can be stored such that classes with higher load factors (more consistent usage throughout the year) are not assigned the same level of costs as classes with less consistent usage (low load factors) and demand profiles.
>
> Such is not the case in the NGDC industry in that, for all intents and purposes, once gas is injected into the distribution system at the city gate, it cannot be stored and is consumed as gas flows through the distribution system. In other words, diversified class non-coincident demands have absolutely nothing to do with how natural gas distribution Mains are designed, operated, or how these costs are incurred.
>
> NGDC's distribution Mains are not designed or operated based on the sum of maximum loads over different days. In short, and at

[1472] *See e.g.* OCA St. 4 at 9.
[1473] OCA St. 4 at 8.
[1474] OCA St. 4 at 9.

> least with respect to NGDCs, the A&E method results in a distinct bias against low load factor customers (because excess demands are greater for low load factor customers than for high load factor customers) in favor of high load factor customers and is in no way correlated or related to how distribution Mains are operated.[1475]

Mr. Watkins also noted that Ms. Ding used a variant of the A&E Method because her assignment of mains excludes all non-coincident peak demands associated with the various interruptible classes.[1476] This further understated the industrial customers contribution to peak demand because, while it is true that interruptible customers may be interrupted during coincident system peak days, there is no such similar interruption on non-coincident peak demand days, which is what the 'excess' demands are based upon.[1477] OCA MB at 166-167.

The OCA submits that, rather than use the A&E Method as described above, the appropriate approach to the classification of distribution mains is the Peak and Average (P&A) Method. The P&A Method is the most fair and equitable method because it recognizes utilization of the Company's facilities throughout the year and also recognizes that some classes rely upon the Company's facilities more than other during peak periods.[1478] OCA MB at 167-168.

The OCA further submits that the use of the P&A Method is also consistent with previous decisions issued by this Commission, the Virginia State Corporation Commission, the Kentucky Public Utility Commission, and the Maryland Public Service Commission.[1479] This method is also recognized by the National Association of Regulatory Utility Commissioners (NARUC), which is discussed in its Gas Distribution Rate Design Manual.[1480] OCA MB at 168.

Accordingly, the OCA submits that the Peak & Average method is the preferred methodology for allocating the costs of natural gas distribution mains. The Commission has

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1475 OCA St. 4 at 10.
1476 OCA St. 4 at 18.
1477 OCA. St. 4 at 18-19.
1478 OCA St. 4 at 12.
1479 OCA St. 4-SR at 4. *See also NFGD 1994*, 1994 Pa. PUC LEXIS 134 at * 320-21.
1480 OCA St. 4-SR at 4; *see also* OCA St. 4-SR, Sch. GAW-2SR at 9-10.

consistently used the Peak & Average methodology for the allocation costs of distribution mains for NGDCs.[1481] As stated by the Commission, "[t]he Peak & Average method that allocates mains equally is a sound and reasonable method of cost allocation and should remain intact."[1482] OCA witness Watkins adopts this methodology and weights the allocation of distribution mains based on 50% average use and 50% demand in accordance with Commission precedent and sound ratemaking principles. OCA MB at 175.

iii. Other Cost of Service Issues

The OCA did not brief other cost of service issues.

b. Revenue Allocation

i. PECO's Revised Revenue Allocation

The OCA notes that the allocation of any revenue increase to the various customer classes is guided in part by the COSS that is used. That is, regulators should consider CCOSS only as a guide, with the results being used as one of many tools to assign class revenue responsibility. As stated by the United States Supreme Court:

> But where, as here, several classes of services have a common use of the same property, difficulties of separation are obvious. Allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science.[1483]

OCA MB at 176.

1481 *Columbia Gas* at 215.

1482 *NFGD 1994*, 1994 Pa. PUC LEXIS 134 at *320-321; *see also Pa. Pub. Util. Comm'n v. Equitable Gas Co.*, Docket No. R-901595, 1990 Pa. PUC LEXIS 135 at *139-42, 154 (Pa. PUC Nov. 21, 1990), *Pa. Pub. Util. Comm'n v. Peoples Natural Gas Co.*, Docket No. R-880961, 1989 Pa. PUC LEXIS 36 at *80-81 (Pa. PUC Jan. 27, 1989) ("In our opinion, the peak and average method appropriately recognizes both demand (peak) and commodity (average) factors in the allocation of system costs.").

1483 OCA St. 6 at 4 (citations omitted).

In its initial presentation of its case, the Company relied on four factors when setting its revenue allocation: (1) the results of Ms. Ding's COSS should be used as a guide; (2) the revenue allocation should move all rate classes closer to the cost of service indicated in the COSS and eliminate the remaining difference between the class rates of return for Rates GC and L and the system average rate of return as required by the 2008 Settlement; (3) adjusting for PECO's Gas Procurement Charge (GPC) and the Merchant Function Charge (MFC); and (4) customer impacts should be considered and avoid any disproportionate increases relative to the system average increase.[1484] OCA MB at 176.

However, due to the error contained in Ms. Ding's COSS, the Company's initial revenue allocation was not appropriately designed to meet those goals. Moreover, when correcting for this change and when accounting for the requirements set forth in the 2008 Settlement regarding the class rates of return for Rates GC and L, the OCA notes that the Company's revised revenue allocation fundamentally differs from the Company's original allocation proposal. As seen in the table below:

Comparison of the Company's Initial and Revised Allocation

Rate Schedule	Initial Class Revenue Allocation*	Revised Class Revenue Allocation**
GR	$43,213,329	$65,413,836
GC	$17,565,938	-$3,441,303
OL	$74	-$14
L	$34,697	$292,545
MV-F	$104,358	$78,533
MV-I	$532	-$734
IS	-	-$3,992
TCS	$55,646	-$497,069
TS-I	$2,377,787	-$74,732
TS-F	$5,370,429	$4,583,269
Total	$68,722,789	$66,193,272

* PECO St. 7, Exh. JAB-1
** PECO St. 7-R, Exh. JAB-1 Revised

PECO witness Bisti asserted that the Company's proposal provided the appropriate balance of the competing interests of all customer classes.[1485] OCA MB at 176-177.

1484 PECO St. 7 at 3.
1485 PECO St. 7 at-R at 5.

The OCA maintains that the Commission should not accept the revenue allocation of the Company. First, Ms. Ding's COSS should not be relied upon as a guide to allocating any revenue increase in this proceeding. Moreover, while the settlement reached in the 2008 base rate proceeding of PECO requires that PECO propose to eliminate any difference between the average rate of return and the class rates of return for Rate GC and L, acceptance of this position would result in rate reductions for rate classes GC, IS, TCS, and TS-I, among others.[1486] As Mr. Watkins testified, however, if a rate increase is granted by the Commission in this proceeding, it would be inappropriate to decrease rates for certain classes, as the residential class would largely be required to make up any lost Company revenue.[1487] OSBA and I&E likewise recognize this is problematic and do not assign any rate decrease to any customer class. OCA RB at 91.

Moreover, the 2008 Settlement is limited in its effect as it only requires that PECO to propose to move Rate GC and L to the system average rate of return in this rate proceeding.[1488] The 2008 Settlement, however, explicitly states that "[a]ll parties retain their rights, in such future rate proceedings, to challenge that proposal through the use of class rates of return obtained through alternative cost of service studies or other ratemaking principles."[1489] Thus, the Commission must exercise its discretion based upon consideration of all the evidence in this proceeding, the alternative COSSs presented, and sound ratemaking principles. OCA RB at 91-92.

The OCA submits that strict compliance with the terms of the 2008 Settlement and PECO's position in this proceeding would produce an unreasonable result at this time.[1490] For example, as I&E indicates in addition to the concern noted above, the Company is proposing a 389% increase to rate class L, which is excessive and violates the concept of gradualism.[1491] Thus, the Company's revenue allocation should be dismissed for the reasons stated above. OCA RB at 92.

1486 *See* PECO Exh. JAB-1 Revised (Corrected).
1487 *See* OCA St. 4 at 25.
1488 *PECO Gas 2008*, Settlement at 5.
1489 *PECO Gas 2008*, Settlement at 5-6.
1490 *See* OCA M.B. at 178; *see also* OCA St. 4 at 25-26.
1491 *See* I&E M.B. at 67.

ii. Opposing Party Alternative Revenue Allocations

While the OCA submits that it is not appropriate to increase a utility's rates at this time, OCA witness Watkins has prepared a revenue allocation should the Commission determine an increase should be given to the Company.[1492] In determining, the revenue allocation in this proceeding, OCA witness Watkins likewise was cognizant of the 2008 Settlement. In other words, this being the Company's second-rate case since 2008, PECO agreed to propose to completely move Rates GC and L to the system average rate of return in this proceeding. OCA MB at 177-178.

Based upon the results of his COSS, Mr. Watkins was aware that Rate GC was currently earning above the Company's requested ROR and would require PECO to propose a significant decrease in rates in order to strictly comply with the 2008 Settlement.[1493] As Mr. Watkins testified, however, that in considering this PECO proposal, current circumstances weigh heavily on the reasonableness of strictly complying with this provision. In other words, any decrease in rates and revenues of Rate GC would need to be primarily recovered from the residential class.[1494] Accordingly, Mr. Watkins concluded that Rate GC should remain at their current levels, rather than receive a decrease.[1495] OCA MB at 178.

Accordingly, Mr. Watkins' proposed revenue allocation assigns no increase or decrease in base rate revenues to those classes that are currently earning higher than the 7.70% rate of return requested by PECO.[1496] This includes Rates GC, OL, L, MV-I, and TCS.[1497] With respect to Rates MV-F, IS, and TS-I, Mr. Watkins recommended that these classes receive one and a half times the system average increase as these classes' current rate of returns are significantly deficient under Mr. Watkins' COSS.[1498] Lastly, Mr. Watkins noted that the relative rate of returns for Rates GR and TS-F are at reasonably close parity at current rates (86% and

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1492 OCA St. 4 at 24.
1493 OCA St. 4 at 25.
1494 *Id*. at 25.
1495 OCA St. 4 at 25-26.
1496 OCA St. 4 at 26.
1497 *Id.*; *see also* OCA St. 4-R at 12.
1498 OCA St. 4 at 26.

79%, respectively) such that he allocated equal percentage increases to these two classes based on the remaining overall increase.[1499] OCA MB at 179.

Mr. Watkins revised revenue allocation was set forth in his Rebuttal Testimony and is as follows:[1500]

TABLE 3-R

OCA Revised "Business As Usual" Class Revenue Allocation

Rate Schedule	Current Distribution Revenue	Total Increase Before GPC & MFC Reduction	GPC Reduction	MFC Reduction	Net Increase Amount	Net Increase Percent
GR	$233,528,109	$61,466,303	($693,000)	($800,000)	$59,973,303	25.68%
GC	$100,578,711	$0	($370,000)	($66,000)	($436,000)	-0.43%
OL	$423	$0			$0	0.00%
L	$75,475	$0			$0	0.00%
MV-F	$474,506	$135,266	($7,000)		$128,266	27.03%
MV-I	$5,022	$0			$0	0.00%
IS	$34,964	$9,967			$9,967	28.51%
TCS	$689,833	$0			$0	0.00%
TS-F	$16,719,224	$4,400,622			$4,400,622	26.32%
TS-I	$9,508,783	$2,710,632			$2,710,632	28.51%
Total Rate Revenue	$361,615,052	$68,722,789	($1,070,000)	($866,000)	$66,786,789	18.47%
Other Revenue	$1,528,291	$88,491			$88,491	5.79%
Total Company	$363,143,343	$ 68,811,280	($1,070,000)	($866,000)	$66,875,280	18.42%

OCA MB at 179-180.

1499 OCA St. 4 at 26.

1500 OCA St. 4-R at 12.

The OCA submits that its proposed revenue allocation is eminently reasonable. It achieves a fair balance by moving the residential class closer to the system average rate of return, while recognizing that some classes are currently earning above the system average rate of return and assigns those customer classes no increase in rates or revenues. This revenue allocation is also reasonable when considered in the context of the other various rate allocation proposals in this case. Accordingly, OCA asserts that Mr. Watkins' proposed revenue allocation should be adopted by this Commission if the Commission determines to increase PECO's rates in this proceeding. OCA MB at 180.

iii. Scale Back of Rates

In the event that the Commission grants PECO a rate increase that is smaller than requested, OCA witness Watkins recommended that any increase be distributed proportionally to the recommended class revenue allocations with no decreases to Rates GC, OL, MV-I and TCS (before recognition of GPC and MFC charges).[1501] In response, the Company agreed with the concept of a proportional scale back.[1502] OCA MB at 181.

In its Reply Brief, the OCA noted that most parties are in general agreement that a proportional scale back is appropriate if a smaller increase is granted by the Commission.[1503] OSBA, however, advocates for a hybrid approach that would scale back some of the current rate revenues assigned to Rate GC, among others.[1504] This would effectively decrease the rates of GC customers at the expense to those customer classes that will bear the brunt of this rate increase. That would be inequitable for the reasons set forth above. OCA RB at 94.

PECO also submits in its Main Brief, that customer charges should be excluded from any proportional scale back.[1505] OCA witness Watkins and I&E witness Cline recommend, however, that any scale back be applied proportionally to the proposed residential customer

1501 OCA St. 4 at 29.
1502 PECO St. 7-R at 6.
1503 PECO M.B. at 115, I&E M.B. at 68-69, PAIEUG M.B. at 28.
1504 OSBA M.B. at 18-19.
1505 PECO M.B. at 115.

charge.[1506] OCA maintains that including the customer charges in any proportional scale back is critical. Moreover, reducing the customer charge increase through a proportional scale back will further incent customers to conserve energy and reduce the amount on their bill.[1507] OCA RB at 94-95.

Accordingly, the OCA asserts that the proportional scale back recommendation of OCA witness Watkins should be adopted by the Commission. OCA RB at 95.

c. Allocation of Universal Service Program Costs

i. Introduction

The Commission recently amended its CAP Policy Statement and directed that the issue of the allocation of universal service costs be addressed in a base rate proceeding.[1508] OCA witness Colton and CAUSE-PA witness Miller recommended that PECO change its allocation of its universal service costs so that those costs are paid by all customer classes rather than just the residential class as PECO proposes here.[1509] PECO witness Colarelli, OSBA witness Knecht, and PAIEUG Witness LaConte opposed the OCA's and CAUSE-PA's proposal to allocate costs to all ratepayers.[1510] PECO witness Colarelli proposed that because of the small size of PECO's natural gas CAP that the issue be addressed in PECO Electric's next base rate proceeding.[1511] The OCA submits that universal service charges should be allocated to all ratepayers and between customer classes on a competitively neutral basis based on a percentage of revenue provided by each customer class at base rates.[1512] OCA MB at 181.

1506 OCA St. 4 at 33; *see also* I&E M.B. at 69.
1507 *See* OCA St. 4 at 31.
1508 52 Pa. Code § 69.265(b); *see also, Final CAP Policy Statement Order* at 80-97.
1509 OCA St. 5 at 56-90, OCA St. 5-SR at 14-34; CAUSE-PA St. 1 at 48-53; CAUSE-PA St. 1-SR at 17-18.
1510 PECO St. 10-R (Revised) at 12; OSBA St. 1-R at 21-30; PAIEUG St. 1-R at 10-13.
1511 PECO St. 10-R (Revised) at 12.
1512 OCA St. 5 at 90.

ii. The Issue of Allocation of Universal Service Costs For PECO's Natural Gas Customers Should Be Addressed in This Proceeding

The OCA explains that historically, electric and natural gas universal service costs have been allocated to residential customers, but this historic practice is not mandated by the law.[1513] The Natural Gas Choice and Competition Act also did not specifically require that universal service costs be allocated to only residential customers. Section 2203(6)-(8) of the Public Utility Code establishes the statutory requirements for natural gas universal service and energy conservation programs.[1514] Section 2203(6) provides, in part:

> After notice and hearings, the commission shall establish for each natural gas distribution company an appropriate nonbypassable competitively neutral cost-recovery mechanism which is designed to recover fully the natural gas distribution company's universal service and energy conservation costs over the life of these programs.

66 Pa. C.S. § 2203(6).[1515] Section 2203(7) provides that the Commission must continue the programs at the "level and nature of the consumer protections, policies and services within its jurisdiction that are in existence as of the effective date of this chapter to assist low-income retail gas customers to afford natural gas services."[1516] The statute also requires that universal service programs be appropriately funded and available to assist low-income customers with affording essential natural gas service. OCA MB at 182.

The Commission issued its *Final CAP Policy Statement Order* in November 2019. In its *Final CAP Policy Statement Order*, the Commission provided:

> We note there is no statutory or appellate prohibition that limits the recovery of CAP costs, whether specifically calculated or as part of total universal service costs, to funding from the residential class. Universal service funding from non-residential classes, while not mandatory, is permissible:

1513 The exception to this policy has been Philadelphia Gas Works. PGW recovers approximately 75% of its costs from residential ratepayers. *Final CAP Policy Statement Order* a 26.

1514 66 Pa. C.S. §§ 2203(6)-(8).

1515 The OCA notes that 66 Pa. C.S. § 2203(10) relates to the establishment of a Universal Service Task Force and does not address cost allocation for natural gas distribution universal service and energy conservation programs.

1516 66 Pa. C.S. § 2203(7).

> Thus, under *Lloyd*, there is no statutory requirement that the funding for special programs come only from those who benefit from the programs. However, the lack of such a requirement does not mean that funding for special programs must come from those who do not benefit.
>
> *MEIUG v. Pa. PUC,* 960 A.2d 189, 202 *(*2008), *citing Lloyd v. Pa. PUC,* 904 A.2d 1010 (Pa. Cmwlth. 2006*).*[1517]

The Commission then provided:

> This Order amends the CAP Policy Statement as indicated in Annex A to address recovery of CAP costs. Consistent with the discussion above, the Commission finds it appropriate to consider recovery of the costs of CAP costs [sic] from all ratepayer classes. Utilities and stakeholders are advised to be prepared to address CAP cost recovery in utility-specific rate cases consistent with the understanding that the Commission will no longer routinely exempt non-residential classes from universal service obligations.[1518]

The OCA and CAUSE-PA recommended the allocation of universal service costs to all customers in this proceeding pursuant to the CAP Policy Statement. OCA MB at 183.

In the recent *Columbia* base rate proceeding, the Commission agreed that the allocation of universal service costs was appropriately raised in the base rate proceeding.[1519] Although the Commission in the *Columbia Gas* base rate decision declined to allocate the costs to all customers, the Commission stated that the decision was based on the evidence in the record of that proceeding and that absent additional compelling reasons, the Commission would maintain the existing universal service cost allocation.[1520] The OCA submits that the Commission should consider the additional record evidence presented in this proceeding regarding the impact of the proposed rate increase on residential customers and, in particular, low-wage customers who do not otherwise qualify for any assistance. OCA MB at 183-184.

[1517] *Final CAP Policy Statement Order* at 92-93 (footnote omitted).
[1518] *Final CAP Policy Statement Order* at 97.
[1519] *Columbia Gas* at 260.
[1520] *Columbia Gas* at 260-261.

Company witness Colarelli recommended instead that the issue be addressed in the next PECO *electric* base rate proceeding because the PECO natural gas customer CAP is much smaller than the PECO electric CAP. The OCA submits that consistent with the final CAP Policy Statement and the Commission's *Final CAP Policy Statement Order,* the issue of cost allocation of universal service costs for PECO has been appropriately raised in this base rate proceeding, and PECO's proposal to address the issue in the next electric base rate proceeding will not address the allocation of natural gas distribution rates.[1521] For the reasons set forth below, the OCA recommends that the Commission approve OCA witness Colton's and CAUSE-PA witness Miller's recommendation to allocate the costs of universal services to all ratepayers. OCA MB at 184.

iii. The Final CAP Policy Statement Order Identifies the Factors the Commission Will Consider

The Commission found that the "current cost recovery method for universal services, including CAP costs, is putting a significant burden on residential customer bills."[1522] The *Final CAP Policy Statement Order* identified several factors to be considered as a part of the analysis of the allocation of universal services costs. In its *Final CAP Policy Statement Order,* the Commission identified factors such as "poverty, poor housing stock, and other factors that contribute to households struggling to afford utility service."[1523] OCA MB at 184-185.

OCA witness Colton specifically examined these Commission-identified factors in his testimony. The OCA submits that the record evidence presented in this case demonstrated that both low-income, non-CAP customers and near-poor, low-wage customers are struggling to afford utility service, and the challenge to afford utility service has been exacerbated by COVID-19.[1524] Mr. Colton presented evidence that examined two aspects of poverty: (1) those customers at or below 150% of the Federal Poverty Level and (2) "near poor" customers whose incomes are

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1521 *See*, OCA St. 5-SR at 15-17.
1522 *Final CAP Policy Statement Order* at 90.
1523 *Final CAP Policy Statement Order* at 94.
1524 *See*, OCA St. 5 at 6-29, 59-62.

above 150% of the Federal Poverty Level but still struggle to make ends meet.[1525] OCA MB at 185.

The first aspect of poverty that Mr. Colton examined relates to those customers who are at or below PECO's income-eligibility maximum. OCA witness Colton testified:

> The process I identify above yields an estimate of roughly 62,000 low-income customers. The Census data for PECO Gas zip codes indicates that the PECO Gas service territory has roughly 12.6% of the population in this service area living with income below 150% of Poverty.[1526]

OCA MB at 185.

The second aspect of poverty that Mr. Colton examined involves those who have income above the maximum income-eligibility for CAP established by the Commission (150% of the Federal Poverty Level (FPL)) but whose income is sufficiently low that they can reasonably be expected to have difficulties paying their utilities bills.[1527] OCA witness Colton defined this population of "near-poor" to include households who have income higher than 150% of the FPL, but lower than 200% of the FPL.[1528] Mr. Colton estimated that an additional 28,000, or 5.7%, of PECO's customers have between 150-200% of the FPL.[1529] OCA MB at 185-186.

OCA witness Colton also examined the vulnerability of these two groups of households. In the first example, he looked at a three-person household with income equal to 150% of the Federal Poverty Level. The household would have income of $31,170, and then compared the household to one that was able to achieve "self-sufficiency" by county.[1530] The data shows substantial variation in the PECO natural gas service territories. For a three-person household (1 adult, 1 school age child, 1 infant), for example, the self-sufficiency income ranges from a low of $63,800 (Lancaster County) to a high of $79,518 (Chester County) in the PECO

1525 OCA St. 5 at 59-62.
1526 OCA St. 5 at 59 (footnote omitted).
1527 OCA St. 5 at 59-60.
1528 OCA St. 5 at 59.
1529 OCA St. 5 at 59-60.
1530 OCA St. 5 at 61.

natural gas service territory.[1531] The OCA submits that these households are not able to achieve self-sufficiency, but at the same time, they are unable to qualify for any assistance and must pay the costs of the universal service programs. OCA MB at 186.

His examination of the impacts of poverty showed that there are a substantial number of residential customers in PECO's natural gas service territory that are near-poor, low-wage customers or who even qualify for CAP but do not participate. These low-income customers must pay for the costs of the universal service programs. OCA witness Colton concluded:

> [f]or purposes of the PUC's consideration of whether to allocate universal service costs over all customer classes, the most important observation here is that tens of thousands of PECO Gas customers with income at or below 150% of Poverty do not participate in CAP notwithstanding their low-income status. In addition, even *more* customers live with incomes that are above the income-eligibility maximum of 150% of Poverty, but less than 200% of Poverty. Allocating universal service costs over all customer classes would help improve the affordability of PECO Gas bills to these low-income and near-poor customers who are income-challenged but not participating in, or not eligible for, PECO Gas' universal service programs.[1532]

OCA MB at 186-187.

The second factor that OCA witness Colton examined is the housing stock.[1533] Although the Census Bureau does not report the age of housing, OCA witness Colton testified that "[n]onetheless, from an energy perspective, one can use the age of housing as a surrogate for which households have control over their energy consumption."[1534] Mr. Colton examined the penetration of older housing stock in zip codes in the PECO natural gas service territory.[1535] He concluded that "the older housing stock in the PECO Gas service territory disproportionately occurs in zip codes with a higher penetration of low-income households."[1536] Mr. Colton

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1531 OCA St. 5 at 62.
1532 OCA St. 5 at 61-62 (emphasis in original).
1533 *See*, OCA St. 5 at 62.
1534 OCA St. 5 at 62.
1535 *Id*. at 63.
1536 OCA St. 5 at 63.

testified that "[i]n short, the Commission was correct to be aware of the relationship between low-income status and poorer housing stock."[1537] OCA MB at 187.

The OCA submits that there is a substantial burden that is placed upon low-income and near-poor, low-wage residential customers. Allocating universal service costs to all customer classes would help to improve affordability for these customers. OCA MB at 187.

iv. Poverty is Not Just a Residential Class Problem

The OCA notes that the Final CAP Policy Statement Order stated that poverty is "not just [a] residential class problem."[1538] The OCA submits that the Commission's statement was also correct. OCA witness Colton examined the economic factors throughout PECO's service territory that contribute to the inability-to-pay of PECO's low-income customers.[1539] OCA MB at 187.

OCA witness Colton found that "according to PECO Gas' data, its CAP participation includes a substantial proportion of participants who are eligible notwithstanding the fact that they receive wage or salary income."[1540] He also found that "a very small proportion of PECO Gas' CAP participants have income from public assistance only."[1541] OCA MB at 187-188.

Although PECO has not studied the economic health of its service territory, OCA witness Colton did examine the underlying economics within the PECO service territory.[1542] Mr. Colton examined wages in the communities comprising PECO's service territory.[1543] He found that "[a] substantial number of employed civilian adults (age 16 or older) in the PECO Gas

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1537 *Id*. at 64.
1538 *Final CAP Policy Statement Order* at 94.
1539 OCA St. 5 at 64-71.
1540 OCA St. 5 at 64, Table 23.
1541 OCA St. 5 at 64.
1542 OCA St. 5 at 66-71.
1543 OCA St. 5 at 67.

service territory are employed in occupations that are generally defined to be "low-wage" jobs."[1544] OCA MB at 189.

OCA witness Colton matched the communities listed in the PECO Gas tariff as comprising its service territory with the corresponding geographic units for which data was reported by the Census Bureau through the American Community Survey (ACS). Through his review, OCA witness Colton found that "[t]he number of workers (civilian age 16 and older) living with these low wages in the PECO Gas service territory is substantial."[1545] The OCA submits low wages contribute to the need for customers to participate in low-income programs. OCA witness Colton's analysis showed that the *Final CAP Policy Statement Order* was correct that poverty is "not just [a] residential class problem."[1546] The economic factors of the service territory contribute as a factor to the poverty problem. Low wages paid by employers contribute to the inability-to-pay for utility service. OCA MB at 189-192.

v. Universal Service Programs Have Broad Economic Benefit

The OCA submits that universal service programs have broad economic benefit. One key area of benefit to businesses is in improving employee productivity. The OCA further submits that the universal service programs support the overall competitiveness of Pennsylvania's economy. Studies by the U.S. Chamber of Commerce and the National Association of Manufacturers and the Brookings Institute Center on Urban and Metropolitan Policy have shown that universal service programs support economic development. OCA witness Colton explained the results of the U.S. Chamber of Commerce and the National Association of Manufacturers' 2004 study as follows:

> Why the under-use of public benefits is a problem. When most people hear about the idea of marketing public benefits through employers, their initial reaction is "why would a company want to get involved with a social service program?"

[1544] OCA St. 5 at 68.
[1545] OCA St. 5 at 70.
[1546] *Final CAP Policy Statement Order* at 94.

> In fact, employers have good reason to be concerned that large numbers of working people with low family incomes do not take advantage of the public benefits intended to help them and their families achieve economic sufficiency--benefits that also help employers by contributing to the economic stability of their workforces. These public benefits bolster the ability of low-income workers to meet their basic needs, in effect providing a wage supplement to employers.[1547]

OCA MB at 192-193.

OCA witness Colton also cited to the Pennsylvania-specific research that has been completed about the value of universal service programs to the competitiveness of Pennsylvania business. OCA witness Colton found that home energy affordability programs help to address utility payment problems, but they also help "address trends toward housing abandonment, reductions in educational attainment, and adverse health outcomes for payment-troubled customers."[1548] OCA MB at 193-194.

In Direct Testimony, OCA witness Colton further discussed the research on the relationship between inability-to-pay and the mitigation of harms to business.[1549] Mr. Colton testified about a 2014 study by the Consumer Financial Protection Bureau (CFPB) that found "even when the economy was booming, financial stress was sapping the productivity and hurting the health of American workers."[1550] OCA MB at 194.

The costs to employers can be substantial, and financial stress can lead to increased health care costs for the employer.[1551] OCA witness Colton noted that the CFPB report found that an increase in health care costs is one of the most cited costs imposed on employers due to financial stress. OCA witness Colton further noted that financial stress can adversely impact employers through absenteeism and presenteeism. OCA MB at 194-195.

1547 OCA St. 5 at 72 (footnote omitted).
1548 OCA St. 5 at 73 (footnotes omitted).
1549 OCA St. 5 at 74-79.
1550 OCA St. 5 at 75-76.
1551 OCA St. 5 at 76-77.

The OCA notes that it is widely understood in industry circles that employee financial problems impact the employer. The OCA further notes that low-income programs, like PECO's natural gas CAP, contribute to economic development and provide substantive benefits to all customer classes. The OCA submits that programs also contribute to the available income within the low-income population that can then be spent in the retail economy on items such as food and clothing.[1552] As OCA witness Colton testified, "it helps drive additional job creation, income generation, and economic activity."[1553] In support of his analysis, OCA witness Colton cited to a study prepared by Entergy Service Corporation, a major electric utility serving the Middle South. The study found that a low-income rate affordability program would be a significant generator of jobs, economic activity, and income throughout the region.[1554] The Entergy study found that the "distribution of energy assistance creates economic activity through the direct delivery of benefit dollars."[1555] OCA MB at 195-196.

OCA witness Colton found that there is a direct relationship between the offer of a universal service program and the economic benefits to local commercial and industrial customers.[1556] Mr. Colton cited the following examples of these economic benefits:

> - Turnover costs businesses money. We know that unaffordable home energy bills lead to the frequent mobility of households.
>
> - Time missed due to family care provision costs businesses money. We know that unaffordable home energy leads to more frequent childhood illnesses.
>
> - Time missed due to lack of employee productivity and employee illness costs businesses money. We know that the inability to stay warm due to unaffordable home energy bills leads to increased illnesses, including pneumonia, influenza, and other infectious diseases.[1557]

OCA MB at 196-197.

1552 OCA St. 5 at 81.
1553 *Id*.
1554 *Id*.
1555 OCA St. 5 at 81.
1556 OCA St. 5 at 80-83.
1557 OCA St. 5 at 80 (footnotes omitted).

OCA witness Colton concluded that "increasing employee productivity contributes to the increased profitability of firms."[1558] Mr. Colton testified:

> With low-wage employees, in particular, unaffordable home energy directly contributes to lowered productivity. Increased personal illness, increased employee turnover, and increased family care responsibilities are but three of the factors contributing to lower employee productivity. The provision of affordable energy through universal service programs such as CAP positively affects each of these productivity factors.[1559]

OCA MB at 197.

The relationship between inability-to-pay and economic growth has also been recognized by the Government Accountability Office (GAO). Mr. Colton concluded "the causes and consequences which I have identified are widely recognized as being attributable to broad social forces unrelated to any particular population that happens to fall into a group which someone has seen fit to label as a particular class of utility customers."[1560] OCA MB at 197-198.

The OCA submits that universal service programs benefit businesses. The programs are often provided to low-wage earners. OCA witness Colton found that the programs help to address the financial stressors that impact overall employee productivity for these low-wage earners and help to support the local economies of the PECO service territory. OCA MB at 198.

vi. The Allocation of Universal Service Costs is Consistent with Sound Ratemaking Principles

The OCA submits that the allocation of universal service costs to all customer classes is consistent with sound ratemaking principles. One well-accepted tenet of utility ratemaking is that certain expenses incurred by the public utility are for "public goods." The costs of PECO's universal service program should be considered a "public good" that should be

1558 OCA St. 5 at 80.
1559 OCA St. 5 at 80.
1560 OCA St. 5 at 83.

allocated across all customer classes. The "public goods" doctrine is applied in a variety of settings to spread designated utility costs over customer classes. Fire hydrants and the basic telecommunications network have been found to be a "public good" as a justification to spread network costs over all customer classes.[1561] OCA MB at 198-199.

OCA witness Colton recommended that the Commission adopt the definition of "public good" articulated by the National Regulatory Research Institute (NRRI).[1562] NRRI provided:

> A public good can be defined as "any publicly induced or provided collective good" that "arise[s] whenever some segment of the public collectively wants and is prepared to pay for a different bundle of goods and services than the unhampered market will produce." (note omitted). In sharp contrast to the private-good model. . ., the emphasis of the public-good model is on the *total* societal benefits—both direct and indirect—associated with network modernization. As applied to the telecommunications network, the public-good model is based upon the premise that the costs of achieving and supporting a modern, state-of-the-art network infrastructure are ultimately borne by the general body of ratepayers as opposed to limited subsets of customers who exhibit a high demand for specific new services. The public-good model is conducive to establishing social policies which provide for a "supply driven definition" of infrastructure.[1563]

The NRRI definition provides:

> Under the public-good model, infrastructure investment[s] that are in the "public interest" are mandated by regulatory commissions, which act as surrogates for marketplace forces for the very reason that those forces break down either because of the enormous risks involved because of uncertainty with respect to costs and demand or both, or because of the intangible or unmeasurable society benefits which are not valued by the marketplace.[1564]

Mr. Colton testified that the NRRI discussion helps to guide the Commission's consideration of the allocation of universal service costs. OCA MB at 199-200.

1561 OCA St. 5 at 84.
1562 OCA St. 5 at 85-86.
1563 OCA St. 5 at 85.
1564 OCA St. 5 at 85 (footnote omitted).

The OCA points to the fact that other states have reached the conclusion that universal service program costs should be allocated to all customers. OCA witness Colton cited to the allocation of universal service costs to all customers in Maine, New Hampshire, New Jersey, Ohio, Illinois, Colorado, and Nevada.[1565] These eight states have Percentage of Income Payment Programs (PIPPs) and allocate the costs to all customer classes.[1566] CAUSE-PA witness Miller also cited to Washington and Oregon as states that allocate costs to all customer classes.[1567] OCA MB at 202.

The OCA submits that universal service costs should be allocated to all customer classes. The programs are not caused by the residential class, and the residential class is not the only beneficiary of these programs. OCA MB at 202.

OCA witness Colton recommended that universal service charges should be allocated between customer classes on a competitively neutral basis based on a percentage of revenue of revenue by each customer class at base rates.[1568] First, this approach reflects the fact that these universal service costs are being treated as a distribution-related expense.[1569] Second, many of the benefits and savings of the programs are captured in the distribution component of the base rates.[1570] Finally, a cost allocation based on class contribution to total revenues would be administratively easy to apply because these revenues are already identified in the Company's filing.[1571] OCA MB at 203.

vii. Proposals to Allocate the Universal Service Costs to Only Residential Customers Should Be Denied

PECO witness Colarelli, OSBA witness Knecht, and PAIEUG witness LaConte presented testimony that opposed the OCA's and CAUSE-PA's proposal to allocate costs to all

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1565 OCA St. 5 at 88.
1566 OCA St. 5 at 88.
1567 CAUSE-PA St. 1 at 53.
1568 OCA St. 5 at 90.
1569 *Id.*
1570 *Id.*
1571 *Id.*

ratepayers.[1572] The OCA submits that many of the arguments raised in opposition to the allocation of universal service costs to all customer classes were extensively addressed in the *Final CAP Policy Statement Order*. Moreover, the COVID-19 pandemic has had a significant and disproportionate impact on residential customers, and in particular, low-wage customers. The OCA submits that the burden of these costs should be shared across all customer classes. For the reasons set forth above and in the *Final CAP Policy Statement Order*, the costs of universal service programs should be allocated to all customer classes. OCA MB at 203.

OSBA witness Knecht's Rebuttal Testimony raised the issue of the merits of collecting universal service costs at all through rates and provides two philosophies of providing universal service, a tax model or an insurance model.[1573] The OCA submits that OSBA's arguments are inapposite given the statutory requirements for universal service programs under Section 2203(6)-(8) of the Public Utility Code.[1574] Universal service programs are required by the Natural Gas Choice and Competition Act and must be funded through utility rates. OCA MB at 204.

The OCA argues that OSBA witness Knecht also incorrectly limited the Commission's decision on this point. OSBA witness Knecht argued that the "rationale for considering a change to the policy appears to be that the low-income assistance programs have become unaffordable to the residential customers who are ineligible or otherwise do not participate in the programs."[1575] The OCA submits that the Commission's decision was much broader. The factors identified include "poverty, housing stock, and other factors" that contribute to low-income and near-poor customers' inability to sustain their own utility service. OCA witness Colton identified the various aspects of poverty and how each of these aspects are not "caused" by the residential class. In particular, OCA witness Colton discussed the impact of other factors, including the wage levels throughout the Company's service territory, that

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[1572] PECO St. 10-R (Revised) at 12; OSBA St. 1-R at 21-30; PAIEUG St. 1-R at 10-13.
[1573] OSBA St. 1-R at 23-24.
[1574] 66 Pa. C.S. §§ 2203(6)-(8).
[1575] OSBA St. 1-R at 22 (footnote omitted).

demonstrate that the residential class is not the "cause" of the need for CAP.[1576] OCA MB at 204; OCA RB at 103.

PAIEUG witness LaConte also opposed the proposed allocation of universal service costs to all customers.[1577] Ms. LaConte argues that allocation to all customers would be an inappropriate subsidy and would be unfair to allocate at this time because only residential customers benefit from the programs.[1578] She also recommends that if the proposal is approved, the cost be limited to $10.85 per customer per year.[1579] The OCA submits that Ms. LaConte's arguments are contrary to the extensive academic research discussed above, including the analysis of the Chamber of Commerce and the National Association of Manufacturers.[1580] OCA MB at 205.

Additionally, OCA witness Colton rejected Ms. LaConte's proposed alternative $10.85 per customer per year cost.[1581] The OCA notes that PAIEUG witness LaConte did not address OCA witness Colton's proposed cost allocation methodology in her testimony. OCA MB at 205.

The OCA argues that the *Final CAP Policy Statement Order* appropriately opened the door for the issue of universal service cost allocation to be addressed in this base rate proceeding. For the reasons set forth above, the OCA submits that the arguments in opposition to the allocation of universal service costs should be denied. OCA MB at 206.

[1576] OCA St. 5 at 64.
[1577] PAIEUG St. 1-R at 10-13.
[1578] *Id*. at 12-13.
[1579] *Id*. at 13.
[1580] OCA St. 5 at-SR at 25-32.
[1581] OCA St. 5-SR at 32-33.

d. Tariff Structure

i. Residential Customer Charge

1. Introduction

OCA witness Colton supported OCA witness Watkins' recommendation to reject the proposed $4.25 increase to the residential customer charge.[1582] The proposed increase to the customer charge from $11.75 to $16.00, or a 36% increase, will have a disproportionate impact on low-income customers. OCA St. 5 at 29. The total costs of the proposed customer charge increase to low-income customers is nearly equal to PECO's total annual Low Income Home Energy Assistance Program (LIHEAP) grants for natural gas service.[1583] Low-income customers are disproportionately low-use use customers who cannot otherwise off-set the costs of the proposed $4.25 increase to the customer charge. The OCA submits, therefore, that the recommendations of OCA witness Watkins should be adopted. To the extent that the Commission determines that an increase to the residential customer charge, the OCA suggests an increase from $11.75 per month to $13.00 per month, or an increase of $1.25 per month.[1584] OCA MB at 207.

2. Low-Income Customers Will Not Be Protected From the Proposed Increase to the Customer Charge

PECO's gas CAP would only protect low-income customers from an increase in rate, "if and to the extent that the program limits the PECO Gas bill to an affordable percentage of income."[1585] And that protection would be limited. OCA witness Colton found that PECO's gas CAP actually "protects a very small proportion of its confirmed low-income customer base from the harms of an increased customer charge."[1586] As such, CAP does not protect the vast majority of PECO's low-income customers from the proposed increase to the customer charge.

1582 OCA St. 5 at 29.
1583 OCA St. 5 at 31.
1584 OCA St. 4 at 31.
1585 OCA St. 5 at 30.
1586 OCA St. 5 at 30.

Moreover, as OCA witness Colton testified, low-income customers have also been disproportionately impacted by the COVID-19 Pandemic and would not be able to take any actions to otherwise mitigate the $4.25 per month increase. See Mr. Colton's discussion of the impact of COVID-19 on low-wage and low-income customers.[1587] OCA MB at 207-208; OCA RB at 113.

The OCA submits that the proposed increase to the residential customer charge will have an adverse impact on low-income customers. Most of PECO's confirmed low-income customers are not enrolled in the Company's CAP and would not otherwise be protected from the 36% increase in the unavoidable part of the utility's rate structure, the customer charge.[1588] OCA MB at 208.

In Rebuttal Testimony, PECO witness Bisti does not address the extensive testimony that OCA witness Colton presented regarding the disproportionate impact of an increase in the customer charge on low-income customers.[1589] Mr. Bisti testified that with "any division of cost between fixed and volumetric components in a customer class will have relative winners and losers."[1590] As OCA witness Colton testified, however, "the evidence in this case is that low-income customers will, disproportionately and on average, be amongst the losers from the PECO Gas proposal to increase its residential customer charge."[1591] OCA MB at 208-209.

3. The Proposed Increase to the Customer Charge Will Harm PECO's Low-Income Customers

An increase of $4.25 per month in the fixed customer charge would represent an increase of $51.00 per year ($4.25 x 12 months = $51.00) for a residential customer. OCA witness Colton testified that PECO reported having approximately 74,914 estimated low-income customers.[1592] Mr. Colton testified that "[u]sing that number, PECO's proposed customer charge

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1587 OCA St. 5 at 5-29.
1588 *See* OCA St. 5 at 32.
1589 *See*, OCA St. 5-SR at 4.
1590 PECO St. 7-R at 10.
1591 OCA St. 5-SR at 5.
1592 OCA St. 5 at 32.

increase, standing alone (i.e., without taking into account any other aspect of the PECO Gas rate increase, will draw $3,812,614 a year out of the Company's low-income population ($4.25/month x 12 months x 74,914 = $3,812,614)."[1593] OCA witness Colton explained the problem with PECO's proposal:

> As shown in the Table below, that is more than the total amount of LIHEAP received by PECO Gas customers in the past two years (program year 2019, program year 2020), and nearly as much LIHEAP as received by PECO Gas customers in program year 2018. (OCA-III-7)[1594]

Table 5. LIHEAP Cash Grants Received by PECO Gas Customers by Year (OCA-III-7)

Date Range	Date Range	Count	Dollars
10/1/17 - 9/30/18	10/1/17 - 9/30/18	21,821	$3,932,016
10/1/18 - 9/30/19	10/1/18 - 9/30/19	13,000	$3,352,426
10/1/19 - 9/30/20	10/1/19 - 9/30/20	14,564	$3,709,858

The OCA notes that the Company did not directly address OCA witness Colton's testimony regarding the LIHEAP grants or that the proposed increase would exceed the amount of LIHEAP cash grants that PECO's gas low-income customers receive. OCA MB at 209.

Company witness Bisti responded that PECO is not involved in "establishing the LIHEAP funding levels."[1595] The OCA submits, however, that PECO witness Bisti missed the point of Mr. Colton's reference to the LIHEAP grants. As OCA witness Colton explained:

> Mr. Bisti's dismissal of my discussion of LIHEAP in my Direct Testimony indicates that he is not recognizing the impact of the PECO Gas proposal on those customers who can least afford to pay the increase in the PECO Gas unavoidable fixed customer charge. While Mr. Bisti is correct when he asserts that "PECO is not involved in the establishment of LIHEAP funding levels," (PECO Gas St. 7-R, at 10), that observation does not detract from the fact that the proposed increase in the unavoidable fixed charge proposed by PECO Gas will have the same impact on PECO Gas

1593 OCA St. 5 at 32.
1594 OCA St. 5 at 31-32.
1595 PECO St. 7-R at 10.

> low-income customers as reducing LIHEAP benefits to $0. The low-income customers of PECO Gas receive federal assistance to help pay their PECO Gas bills. The PECO Gas proposal to increase its fixed monthly customer charge, standing alone, effectively reduces the benefits of LIHEAP assistance to nothing. (See OCA St. 5, at 31). For every dollar in assistance that LIHEAP delivers to PECO Gas low-income customers, PECO Gas is effectively proposing to remove a dollar through its proposed increase to the fixed monthly residential customer charge.[1596]

OCA MB at 210.

The OCA further argues that PECO failed to refute the additional harms to low-income customers identified by Mr. Colton including that the proposal will: (1) increase the depth and breadth of customer arrears; (2) increase the incidence of service disconnections and threat of service disconnections; (3) reduce the ability of low-income customers to respond to their inability-to-pay through usage reductions; and (4) increase the Home Energy Insecurity.[1597] OCA MB at 210-211.

The OCA maintains that the data that Mr. Colton references regarding confirmed low-income customer's payment difficulties is directly relevant to the reasonableness of the Company's proposed increase to its customer charge. OCA witness Colton testified:

> What PECO Gas is doing is increasing the unavoidable fixed monthly customer charge, resulting in a disproportionately higher percentage bill increase, to those customers who can least afford to make their bill payments in the first instance. Not only does this place the continuation of service to these low-income customers in jeopardy, but this also causes PECO Gas to incur credit and collection costs that will, in turn, be passed on to all ratepayers in future rates.[1598]

The OCA submits that the proposed customer charge increase will harm low-income customers in a way that low-income customers are otherwise unable to mitigate. The effect of the proposed increase on low-income customers will be nearly equal to the total amount of LIHEAP grants received for PECO's natural gas customers. The non-CAP, low-income customer population is

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1596 OCA St. 5-SR at 5.
1597 OCA St. 5 at 33; OCA St. 5-SR at 14.
1598 OCA St. 5 at 37.

already payment-troubled, and the proposed fixed customer charge will only increase those payment challenges, particularly in the context of the significant financial impact of the COVID-19 Pandemic on low-income customers. OCA MB at 211.

4. Low-Income Customers Are Disproportionately Low-Use Customers Who Cannot Otherwise Off-set the Proposed Increased Customer Charge

Low-income customers are disproportionately, and on average, low-use customers.[1599] OCA witness Colton found that there is a direct correlation between low-income customers and low natural gas usage. With lower consumption and a higher fixed monthly customer charge, the OCA submits that low-income customers do not have the ability to mitigate the proposed rate increase. OCA MB at 211-212.

As OCA witness Colton testified, PECO has not completed an analysis of the relationship between income and usage. Nor did PECO witness Bisti address the extensive evidence presented by OCA witness Colton regarding the relationship between history and usage.[1600] PECO did, however, provide the average monthly consumption for residential customers and for confirmed low-income customers.[1601] After examining the PECO Gas average monthly consumption data, OCA witness Colton found "[t]he PECO Gas numbers . . . show proportionately fewer low use residential customers, and proportionately more high use residential customers (as compared to confirmed low-income) even though the bulk of the confirmed low-income customers are CAP customers, who are exclusively higher use heating customers."[1602] OCA MB at 212-213.

OCA witness Colton also completed two demographic analyses that support his assertions that low-income customers use less natural gas than other residential customers. First, in his zip code analysis, OCA witness Colton relied upon a 2009 Department of Energy (DOE) Residential Energy Consumption Study (RECs Study). The DOE RECs Study found that as

1599 OCA St. 5 at 38-55.
1600 OCA St. 5-SR at 5.
1601 OCA St. 5 at 40.
1602 OCA St. 5 at 39-40.

incomes increase, natural gas usage also correspondingly increases.[1603] Moreover, the DOE RECs Study showed renters tend to use less natural gas than do homeowners, holding constant the type of housing unit occupied.[1604] OCA witness Colton performed an analysis that demonstrated there was a strong correlation between low-income status and renter status in PECO's service territory.[1605] Based upon the DOE RECs data, OCA witness Colton testified that "[o]ne would conclude from this data that natural gas usage in the low-income housing units in the PECO Gas service territory is lower than natural gas consumption in the non-low-income housing units."[1606] OCA MB at 213.

Second, Mr. Colton examined the number of rooms in a housing structure as compared to the average household income. The RECs study also showed that there is a correlation between the size of a housing unit and natural gas consumption.[1607] OCA witness Colton reached this same conclusion when he analyzed PECO-specific data.[1608] More specifically, Mr. Colton examined the housing stock (single-family homes vs. multi-family homes) by zip code and compared the data to the income levels in the zip codes.[1609] OCA witness Colton concluded "it is clear that the housing stock in the PECO Gas service territory is such that the building types with the lowest natural gas consumption (multi-family buildings, excluding those with only 2-4 units) are found within the lowest income zip codes."[1610] OCA MB at 213-214.

OCA witness Colton further tested his conclusions through several different reviews. Mr. Colton tested his conclusions by examining the relationship between income and PECO home heating bills; redefining income in terms of dollars instead of Federal Poverty Level and comparing the PECO home heating bills; examining the relationship between PECO home heating bills and the receipt of food stamps (SNAP); and examining the relationship between

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1603 OCA St. 5 at 40-41.
1604 OCA St. 5 at 41.
1605 OCA St. 5 at 40-43. OCA St. 5 at 40-41.
1606 OCA St. 5 at 43.
1607 OCA St. 5 at 44.
1608 *See* OCA St. 5 at 45-47, Tables 13-14
1609 OCA St. 5 at 48-50, Tables 16-17.
1610 OCA St. 5 at 50.

PECO home heating bills and the receipt of CAP.[1611] Each of those tests supported Mr. Colton's conclusion. Mr. Colton concluded that "the PECO Gas proposal to substantially increase its fixed monthly customer charge will disproportionately impose adverse impacts on low-income customers."[1612] In Rebuttal Testimony, the Company did not address Mr. Colton's analysis or the DOE study. Regarding Mr. Colton's conclusion that low-income customers are disproportionately low-use customers, Company witness Bisti only testified:

> PECO's proposal to increase the residential customer charge will provide a relative benefit to high-use, low-income customer, by lessening the impact of the overall rate increase. Any division of cost between fixed and volumetric components in a customer class will have relative winners and losers, and the Company believes that its proposal to provide a relative benefit to high-usage low-income customers, who are more likely to experience high monthly bills, is reasonable.[1613]

Mr. Bisti's testimony did not directly address the analysis performed by Mr. Colton. As OCA witness Colton testified:

> Mr. Bisti offers no facts, however, to support his claim that low-income customers are high-usage. His Rebuttal Testimony does not attempt to counter the extensive analysis presented in my Direct Testimony that low-income customers in the PECO Gas service territory disproportionately, and on average, tend to be low use customers. Thus, while I agree with Mr. Bisti that "any division of cost between fixed and volumetric components in a customer class will have relative winners and losers," (PECO Gas St. 7-R, at 10), the evidence in this case is that low-income customers will, disproportionately and on average, be amongst the losers from the PECO Gas proposal to increase its residential customer charge.[1614]

While Company witness Bisti does not agree with Mr. Colton's conclusions, the Company has not presented any evidence to rebut his detailed analyses. OCA MB at 214-215.

1611 OCA St. 5 at 50-55, Table 18-20.
1612 OCA St. 5 at 55.
1613 PECO St. 7-R at 10.
1614 OCA St. 5-R at 5.

The OCA submits that Mr. Colton has conclusively demonstrated that low-income customers are disproportionately low-use customers and would be disproportionately impacted by the proposed customer charge increase. As low-use customers, low-income customers would not have the ability to otherwise avoid the impact of the $4.25 proposed increase to the customer charge. PECO has been unable to refute the impact the proposed increase will have on low-income, low-use customers. OCA MB at 215.

ii. Non-Residential Customer Rate Design

1. Rate GC Customer Charge

The OCA did not brief this specific issue.

2. Rate GC Declining Block Volumetric Charge Differential

The OCA did not brief this specific issue.

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

The OCA did not brief this specific issue.

4. Elimination of Rate IS Margin Sharing

OCA witness Watkins and OSBA witness Knecht recommended that the Company remove its practice of margin sharing for Rate IS revenues.[1615] In the Company's Main Brief, it agreed to propose the elimination of the disputed Rate IS sharing mechanism on or before December 1, 2021, as part of its next annual PGC reconciliation filing.[1616] The OCA supports this position and the Commission should require the Company to propose to eliminate

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[1615] *See* OCA M.B. at 216-219.
[1616] PECO M.B. at 123.

its Rate IS sharing mechanism as part of the Company's next annual PGC reconciliation filing. OCA RB at 119.

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

The OCA did not brief this specific issue.

iii. Distribution System Improvement Charge (DSIC) Cost Allocation

The OCA did not offer a position on this issue.

iv. Negotiated Gas Service

During the investigation of the Company's rate filing, OCA witness Watkins determined that the Company had six negotiated rate service (NGS) customers that were receiving rate discounts for the provision of natural gas service. In some instances, it was determined that the Company's NGS customers had been receiving discounted rates for a number of years. Thus, the OCA recommends that the Commission require the Company to reevaluate the terms and rates for each of the three negotiated rate contracts identified in the Direct Testimony of OCA witness Watkins. OCA MB at 219.

In response to OCA discovery, the Company indicated that PECO had negotiated rate discounts with six customers and each customer had demonstrated the existence of a viable and competitive alternative at the time of the agreement.[1617] During the course of OCA witness Watkins' review of these agreements, however, Mr. Watkins observed that three of the contracts were very old and there had been no increases for many years.[1618] Thus, OCA witness Watkins recommended the following:

> I recommend the Commission order PECO to completely reevaluate the terms and rates for each of the three negotiated rate

[1617] OCA St. 4 at 32.
[1618] *Id.*; *see also* OCA St. 4 at 32-33 (Confidential Version).

> contract customers discussed above. This reevaluation should include a detailed analysis of each customer's ability to use alternative fuels, whether such alternative fuels could viably be used to replace some or all of its current natural gas usage, a detailed analysis of the burner tip cost of the identified alternative fuel(s), and a financial analysis supporting each negotiated rate with adjustments to the current rates as appropriate. These findings should be provided to the Commission and OCA on, or before, the Company's next rate case filing.[1619]

OCA MB at 219-220.

Similarly, OSBA witness Knecht took issue with certain aspects of the negotiated rate customer contracts.[1620] Thus, he recommended that if the Commission determines that, for the TS-F class, if any of the Company's negotiated rate discounts are not justified, additional revenues from these customers should be used to reduce the rate increase required from other TS-F customers.[1621] For the TS-I class, Mr. Knecht recommended that additional revenues should be first used to reduce the rate increase of other TS-I customers, but if any revenue increase would bring the TS-I revenues into line with the allocated cost, any additional revenues should then be credited to the Rate GR residential class.[1622] OCA MB at 220.

I&E witness Cline also recommended that the Company provide an update to the competitive alternative analysis for any customer that had not had its alternative fuel source verified for a period of five years or more when PECO files a base rate case and that the Company cease NGS service to any customer that does not have a verified alternative supply.[1623] Mr. Cline also recommended that, in future base rate cases, PECO separate the costs and revenues of customers with discounted rates into their own class in the COSS.[1624] OCA MB at 220.

Thus, the OCA submits that the Commission should adopt the recommendation of OCA witness Watkins. It is reasonable to ensure the continued provision of a viable,

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1619 OCA St. 4 at 33-34.
1620 *See* OSBA St. 1 at 39-42 (Confidential).
1621 *See* OSBA St. 1 at 42.
1622 *Id*.; *see also* PECO St. 7-R at 21.
1623 *See* PECO St. 7-R at 21.
1624 *Id*., at 21-22.

competitive alternative for NGS customers to ensure their discounted rates are shown to be just and reasonable and not unduly discriminatory. This is consistent with the Commission's recent Opinion and Order issued in Columbia Gas' 2020 rate case at Docket No. R-2020-3018835:

> [W]e agree with the ALJ and I&E that it is important to periodically analyze competitive alternatives to ensure that the rates of the flex-rate customers are not discounted lower than is necessary to avoid the customer choosing the alternative supply. As I&E witness Mr. Cline indicated, this analysis is needed to provide an accurate and up-to-date analysis of competitive alternatives to show the flex rate is necessary and reasonable and to ensure that flex-rate customers make the maximum contribution to fixed costs. I&E St. 3-SR at 5. We especially agree with the ALJ and I&E that providing excessive discounts to customers is not in the public interest and would be harmful to both the Company and its customers, since the other customers would be required to make up the lost revenues when flex-rate customers pay less than tariff rates.[1625]

Accordingly, OCA maintains that the Commission should adopt the recommendation of OCA witness Watkins. OCA MB at 220-221.

v. Theft/Fraud Investigation

In its base rate filing, PECO proposed to increase the Company's "Theft/Fraud Investigation Charge" in its proposed Tariff Rule 17.7 from $370 [1626] to $460.[1627] The proposed Tariff Rule 17.7 states:

> If the Company's meters or other Company equipment on the customer's premises have been tampered or interfered with by any means whatsoever, the customer being supplied through such equipment whether an applicant or a customer as defined at pa [sic] C.S. § 1403 shall pay a theft/fraud investigation charge in addition to any amount that the Company estimates is due for service used, but not registered on the Company's meter. These

[1625] *Columbia Gas* at 240.

[1626] OCA St. 5-SR at 9, referencing the fee identified in existing Tariff Rule 17.6.

[1627] OCA St. 5 at 109; PECO St. 7, Exh. JAB-2, PECO Energy Co. Gas Service Tariff, Pa. P.U.C. No. 4, Original Page No. 27, Tariff Rule 17.7. The OCA notes that PECO amended its proposal in Rejoinder Testimony to eliminate inclusion of fraud in the tariff provision. Tr. at 202.

> theft/fraud investigation charges listed below include allocated overheads, all investigative costs and administrative cost [sic] deemed necessary by the Company to correct any and all unauthorized conditions at the premise. The Company reserves the right to assess theft/fraud investigation charges as a precedent to reconnection of service as well as the right to assess a separate reconnection charge as described in Rule 17.6.[1628]

The OCA submits Tariff Rule 17.7 is overly broad, fatally flawed, and should not be approved. The OCA also submits that the Company has not met its burden to demonstrate that the proposed $90 increase to the charge is cost-based and should be applied as proposed to both customers and "applicants." OCA MB at 221-222.

The OCA submits that under the language of the tariff, the charge is "applicable if the Company alleges that its equipment has been interfered with 'by any means whatsoever.'"[1629] As OCA witness Colton testified, "[n]ot only is there no limit on what might deem to be 'interference,' but there is no limit on what activities PECO deems to be covered by the charge. Moreover, while the proposed tariff references meter tampering, the charge is not limited to meter tampering."[1630] The language of the tariff still does not require the Company to provide any factual demonstration that the customer has engaged in meter tampering or "interference" with PECO's metering equipment.[1631] OCA witness Colton also identified a concern that the tariff language, "unauthorized conditions at the premises," is also undefined and is at the discretion of the Company to define.[1632] OCA RB at 120-121.

The OCA further submits that the consequences of not paying the fee are severe for both customers and "applicants." As OCA witness Colton explained, "applicants" are at risk that the Company will refuse to connect service to a new customer unless the proposed charge is paid.[1633] OCA witness Colton also identified concerns that low-income customers will be

[1628] PECO St. 7, PECO Exh. JAB-2, PECO Energy Co. Gas Service Tariff, Pa. P.U.C. No. 4, Original Page No. 27, Tariff Rule 17.7; *see also*, OCA St. 5 at 109.
[1629] OCA St. 5 at 110.
[1630] *Id.*
[1631] OCA M.B. at 224.
[1632] OCA St. 5 at 111.
[1633] OCA M.B. at 226; OCA St. 5 at 113.

disproportionately impacted by the proposed fee and accusations of theft and unauthorized use.[1634] OCA RB at 121-122.

The OCA submits that Tariff 17.7 is overly broad and fatally flawed. The OCA also submits that the Company has not met its burden to demonstrate that the proposed $90 increase to the charge is cost-based and should be applied as proposed to both customers and "applicants." Moreover, PECO has not adequately explained how the inclusion of overhead and administrative costs will be off-set by the proposed $10,000 adjustment to base rate revenues and why there will not still be a double-recovery of these costs. As such, the OCA submits that PECO's proposed Tariff Rule 17.7 should not be approved. OCA MB at 226-227.

e. Summary and Alternatives

The OCA submits that the Commission should adopt the following recommendations of the OCA regarding rate structure: (1) adoption of OCA Watkins' COSS and use of the P&A Method to allocate distribution mains, (2), adoption of OCA Watkins' proposed revenue allocation if any rate increase is approved in this proceeding, (3) adoption of OCA witness Colton's recommendation to allocate universal service program costs across all customers classes, (4) adoption of OCA witness Watkin's recommendation to eliminate Rate IS – Interruptible Service margin sharing, (5) require PECO to reevaluate the terms and rates for each of the three negotiated rate contracts identified in the Direct Testimony of OCA witness Watkins and provide its findings in its next gas base rate case, and (6) deny the Company's proposed changes with respect to proposed Rule 17.7. OCA MB at 227.

[1634] OCA M.B. at 226; OCA St. 5 at 113.

4. OSBA's Position

a. Cost of Service

i. PECO's Class Cost of Service Study

The OSBA asserts that PECO's COSS is not consistent with Commission precedent, including the recent Columbia Gas decision. The OSBA concludes that PECO's use of a load-factor-weighted A&E method in its revised GCOSS should be rejected. If an A&E method is to be retained, it should be the 50/50 A&E method approved by the Commission in the PGW matter. OSBA MB at 11.

The OSBA further asserts that a significant portion of the costs in an NGDC's GCOSS is allocated directly (or indirectly through an A&E method) using a design day demand allocation factor. Because most gas customers are not daily metered, the Company must develop estimates of customers daily usage under extreme weather conditions – both for system planning and gas procurement purposes. For cost allocation purposes, the Company must develop these "design day" demands on a class-by-class basis. OSBA MB at 11.

In this proceeding, OSBA witness Knecht expressed concern regarding PECO's class-specific design day demand estimates. Aside from the issues involving Rate L, Mr. Knecht's concerns in his direct testimony involved (a) the derivation of class-specific design day demands for smaller, non-daily-metered customers, and (b) the design day demands for Rate TS-F customers.[1635] To address both of those issues, Mr. Knecht applied a statistical analysis of the historical weather sensitivity of customer loads to develop alternative design day demand estimates.[1636] OSBA MB at 11-12.

Regarding the TS-F design day demand, the Company's rebuttal testimony adjusted its proposed design day demand to properly exclude a demand from a customer served

[1635] OSBA Statement No. 1, at 26.
[1636] OSBA Statement No. 1, at 28.

by direct-assigned mains. Mr. Knecht agreed with this correction in his surrebuttal testimony, and he accepted that revision to the design day demand estimate for Rate TS-F.[1637] No other party put on evidence contesting that value. The OSBA deems it significant that the PAIEUG expert did not contest the Company's demand allocator for the TS-F rate class. As Mr. Knecht indicated, this change served to increase costs and revenue assigned to the TS-F class compared to what is set forth in his direct testimony.[1638] OSBA MB at 12.

The OSBA submits that Mr. Knecht's estimates of design day demands for smaller customers are superior to those offered by the Company, and that this provides another reason why the Company's GCOSS is not appropriate for this proceeding. OSBA MB at 13.

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

The OSBA notes that because the OCA GCOSS as revised in rebuttal testimony is consistent with the more recent Commission precedent set forth in *Columbia Gas*, and because it correctly reflects Mr. Knecht's proposed changes to design day demand allocation factor, the OSBA does not object to the use of the OCA's GCOSS P&A methodology in this proceeding, notably with the correction to the design day demand allocation factors. OSBA MB at 13.

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

1637 OSBA Statement No. 1-S, at 9-10.
1638 OSBA Statement No. 1-S, at 13.

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

OSBA MB at 14.

As shown above, the Rate GC class exhibits a class rate of return well above system average under all methods proposed in this proceeding. In fact, the Rate GC class return at present rates exceeds the system average proposed rate, which means a rate decrease is necessary to move rates into line with allocated cost. The primary issue of debate involves the disparate results for the transportation service classes. PECO's GCOSS, supported by I&E and PAIEUG, assign a lower share of costs to the transportation service classes, while the OCA and OSBA methods assign a higher share. This choice is substantially dependent on whether the Commission retains its historical expressed preference for including average demand in its mains cost allocation policy. The OSBA submits that the OCA and OSBA methods are consistent with Commission precedent; the PECO method is not. OSBA MB at 14.

iii. Other Cost of Service Issues

The OSBA did not brief other cost of service issues.

b. Revenue Allocation

i. PECO's Revised Revenue Allocation

The OSBA notes that this proceeding involves two unusual features for revenue allocation. First, as explained earlier, PECO's filed GCOSS contained a serious error that distorted the Company's revenue allocation and rate design. The OSBA asserts that since this error was not corrected until the rebuttal stage of this proceeding, it must be acknowledged that the Company's original revenue allocation proposal must be rejected in its entirety. OSBA MB at 15.

Second, as OSBA witness Knecht explained, in the settlement of the Company's 2008 base rates proceeding, the Company agreed that it would propose to align class rates of return for the Rate GC and Rate L classes with the system average over its next two base rates proceedings.[1639] *This* is the second proceeding. While PECO failed to meet its commitment in its filing, it did so in its rebuttal testimony. While the settlement of the 2008 proceeding allowed other parties to oppose that proposal based on alternative cost allocation and rate design criteria, the OSBA respectfully submits that the parties to the 2008 settlement recognized that there was a significant inequity in rates for those two classes that needed serious remediation. As shown in every COSS filed in this proceeding, that need is still very real for the Rate GC class, which consistently exhibits class rates of return well above system average at current rates. OSBA MB at 15.

ii. Opposing Party Alternative Revenue Allocations

In its role as an advocate for small businesses, OSBA does not contest the Rate GC revenue allocation proposals of PECO, OCA or I&E. The OSBA observes that, while PECO, I&E and PAIEUG all support the Company's rebuttal GCOSS, they offer substantially different recommendations for rate increases to the TS-F and TS-I rate classes. The OSBA will not attempt to explain this substantial inconsistency, and observes only that all of these proposals

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[1639] OSBA Statement No. 1, at 5.

are based on a COSS that is now clearly inconsistent with Commission precedent. As such, the credible proposals for revenue allocation to the TS-F and TS-I classes are those offered by OSBA and OCA. OSBA MB at 16.

iii. Scale Back of Rates

OSBA witness Knecht recommended a "hybrid" approach to a scale back of rate increases in this proceeding:

> In this case, there is (somewhat unusual) agreement among the parties that the Rate GC class is substantially over-recovering allocated costs and should be assigned a minimal increase at the full revenue requirement. Much of the progress toward cost-based rates for that class would be lost, however, with a proportional scaleback and a material reduction in the rate increase. I therefore propose a hybrid approach to a scaleback, in which the rate reduction is scaled back partly based on the proportional scaleback method and half based on current rate revenues.

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

> [T]his approach allows the GC class to partially share in the overall reduction of the revenue requirement, much of which would be lost in a traditional proportional scaleback. It may, of course, be argued that assigning the Rate GC class a rate decrease is inequitable when all other classes are assigned rate increases.
>
> However, I note (a) [I&E witness] Mr. Cline actually proposes a rate decrease for rate GC even at the full revenue requirement, (b) not allowing the Rate GC class to benefit at all from a significant reduction in the revenue requirement would be inequitable, and (c) there is significant agreement among the parties that the Rate GC class revenues should be reduced materially relative to all other rate classes to reflect allocated costs.
>
> Thus, in the context of this proceeding, I do not believe this scaleback proposal is inequitable or unreasonable.[1640]

OSBA MB at 18-19.

[1640] *Id.* at 20.

The OSBA respectfully proposes that Mr. Knecht' scaleback mechanism be applied to any reduction in the overall proposed increase. OSBA MB at 19.

c. Allocation of Universal Service Program Costs

The OSBA notes that the Company proposed to continue to recover costs for its Universal Service programs for low-income customers from the Rate GR residential class. This policy was supported by OSBA and PAIEUG, and opposed by OCA and CAUSE-PA. This debate was triggered by the Commission in its recently updated Policy Statement on Customer Assistance Programs, which opened the door for reconsideration of the Commission's long-standing precedent to assign these costs entirely to the residential rate classes. This issue has arisen in two recent base rates proceeding, namely the *UGI Gas* proceeding at Docket No. R-2019-3015162 and the *Columbia Gas* proceeding at Docket No. R-2020-3018835. The methodological issues and the debate in those proceedings and the current proceeding are essentially identical. The *UGI Gas* case was resolved by settlement. After the presentation of evidence in this proceeding, the Commission reached a decision on this issue in the *Columbia Gas* matter. In that case, the Commission determined:

> In consideration of the large percentage increases to the large C&I classes, based on the Company's full requested increase, as well as the economic impacts commercial and industrial customers are experiencing due to the COVID-19 pandemic, absent more compelling evidence to the contrary, we do not find it appropriate to change the manner in which we have traditionally permitted USP costs to be allocated under the circumstances in this case.[1641]

OSBA MB at 19-20.

The OSBA respectfully submits that the factual considerations which led to the Commission's decision in the *Columbia Order* are similar to those in the current proceeding. First, the COVID-19 Pandemic rages on, and the timing, duration and effectiveness of the recovery remain in doubt. Second, ratepayer impacts for larger customers are likely to be

1641 *Columbia Order* at 261.

similar, particularly if the Commission adopts the 50/50 P&A mains cost allocation methodology it did in the *Columbia Order*. The rate increases for the TS-F and TS-I classes proposed by both the OSBA and OCA witnesses in this proceeding are well above system average and are constrained by rate gradualism concerns, resulting in rate increases that are insufficient to move revenue into line with allocated costs. Further burdening these classes with universal service charges would be inconsistent with the principle established the *Columbia Order*. OSBA MB at 20.

In addition, the OSBA observes that no party other than OSBA has attempted to evaluate the impact of including an alternative allocation of universal service costs in the context of overall revenue allocation. As Mr. Knecht's analysis demonstrates, the cost allocation analysis using any of the COSSs filed in this proceeding would imply that the Rate GC should be assigned a significant rate decrease. Under the OSBA's proposal, that increase would be set to zero, to reflect rate gradualism considerations as well as the impacts of the COVID-19 Pandemic. However, even if the OCA alternative allocation for universal service costs were approved, a reasonable overall revenue allocation approach would still produce a zero increase for the Rate GC class. OSBA MB at 21.

Therefore, because changing the universal service cost allocation methodology would (a) unduly burden large customers, and (b) have little impact on OSBA's proposed revenue allocation for the Rate GC class, the OSBA respectfully submits that any change in the allocation methodology for these costs be deferred until such time as the issue of mains cost allocation is fully clarified and the impacts of that change are fully reflected in rates for larger industrial customers. OSBA MB at 21.

d. Tariff Structure

i. Residential Customer Charge

The OSBA did not brief this specific issue.

ii. Non-Residential Customer Rate Design

1. Rate GC Customer Charge

In its initial filing, PECO proposed to increase the Rate GC customer charge from $28.55 to $40.00 per month. In his direct testimony, Mr. Knecht explained that the Rate GC customer charge should reflect the costs for the smaller customers within the GC class, and not the average for the entire class. He therefore recommended that no increase be assigned to the Rate GC customer charge.[1642] OSBA MB at 24.

In PECO's rebuttal testimony, the Company decided to keep the customer charge for rate GC at $28.55 per month – *i.e.*, a zero dollar increase over current rates.[1643] No other party addressed the Rate GC customer charge. The OSBA supports PECO's proposed customer charge for rate GC. OSBA MB at 24.

2. Rate GC Declining Block Volumetric Charge Differential

PECO's Rate GC tariff currently includes a two-tier declining block volumetric tariff charge. As Mr. Knecht explained, this tariff structure provides for lower average rates for larger customers relative to smaller customers. Too often in base rates proceedings do these specific tariff design matters go unanalyzed, because they principally serve to allocate the class' revenue requirement within the class. In this proceeding, Mr. Knecht prepared an analysis of the primary factors that may justify a rate differential between smaller and larger customers within the Rate GC class. He concluded that the existing rate differential was not supported by the analysis, and he recommended that the Company narrow the tariff charge differential.[1644] OSBA MB at 25.

[1642] OSBA St. No. 1, at 48-50.
[1643] OSBA St. No. 1-S, at 18-19.
[1644] OSBA St. No. 1, at 50-52.

In rebuttal testimony, the Company accepted Mr. Knecht's proposal.[1645] Mr. Knecht created a table setting forth both the Company's updated rebuttal GC monthly customer charge and the Company's updated rebuttal GC declining block rates. That table is set forth below:[1646]

Table IEc-S5 PECO Gas Rate Design Proposal: Rate GC				
	Current Rate	**Filed Rate**	**Rebuttal Rate**	**Rebuttal Percent**
Customer Charge ($/mo.)	$28.55	$40.00	$28.55	0.0%
First 200 mcf ($/mcf)	$3.7319	$4.5625	3.7837	1.4%
Over 200 mcf ($/mcf)	$2.5924	$3.1694	2.8509	10.0%
DSIC Average* ($/mcf)	$0.2103	$0.0000	$0.0000	-100%
TCJA Average* ($/mcf)	$0.0549	$0.0000	$0.0000	-100%
Average Excl PGC/MFC/GPC	**$4.490**	**$5.255**	**$4.292**	**-3.9%**
* Applied as a percent, so the per-mcf rate varies with customer load. Sources: RDK WP1, "RevPrf" tab.				

OSBA MB at 25.

The OSBA supports PECO's proposed declining block rates for rate GC as modified in PECO's rebuttal testimony. OSBA MB at 26.

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

The PECO Gas transportation tariffs include a firm service option (TS-F) and an interruptible service option (TS-I). However, within each tariff class, the Company has completely different customer and volumetric charges for customers *under* and customers *over* 18 million cubic feet per year. The Company does not separate these customer groups for cost allocation, and it refused to provide the information necessary for Mr. Knecht to do so.[1647] OSBA MB at 26.

1645 PECO St. No. 7-R, at 15.
1646 OSBA St. No. 1-S, at 19.
1647 OSBA St. No. 1, at 19.

In the absence of detailed cost allocation data, Mr. Knecht reviewed the available information regarding relative cost causation for the smaller and larger customers within each tariff class. He recommended that the volumetric rate differentials for service above and below 18 mmcf per year in the TS-F and TS-I tariffs be narrowed, to better align rates with the relative load factors of smaller and larger customers.[1648] OSBA MB at 26.

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

> Subsequent to my preparation of this analysis, the Company submitted its response to PAIEUG-V-1. As this response was not filed until late afternoon on February 8, 2021 (yesterday), I have not reviewed it carefully. However, this response appears to recognize that the Company had not narrowed the rate differential within the TS-I rate class as it intended, and it presented a correction to do so. Based on a quick review, it appears that the Company's correction is very similar to that shown in RDK WP-1S.[1649]

OSBA MB at 26-27.

Because PECO's revised proposal in PAIEUG-V-1 is consistent with Mr. Knecht's proposal for Rate TS-I, and because the Company's rebuttal proposal for Rate TS-F is similarly consistent with Mr. Knecht's proposal, the OSBA recommends that the Company's revised proposals for rate differentials between small and large customers in Rates TS-F and TS-I be approved. OSBA MB at 27.

[1648] OSBA St. No. 1, at 52-56.
[1649] OSBA St. No. 1-S, at 22, n.14.

4. Elimination of Rate IS, Margin Sharing

Dating to a policy adopted in the Carter administration, the Company proposed to retain a sharing mechanism for Rate IS (interruptible sales service), in which market-based rate revenues in excess of the cost of gas are shared between purchased gas cost customers (75%) and PECO shareholders (25%). No revenues were credited to base rates. OSBA MB at 27.

Consistent with the direct testimony of Mr. Knecht and OCA witness Watkins, the Company modified its originally filed proposal in rebuttal to eliminate this sharing mechanism. To OSBA's knowledge, no party supports a continuation of this archaism. The OSBA respectfully submits that the sharing mechanism should be eliminated. OSBA MB at 27.

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

In Mr. Knecht's direct testimony, he recommended that the Company consider eliminating its legacy market-based interruptible bundled service rate classes, namely MV-I, TCS and IS.[1650] Mr. Knecht explained his recommendation, as follows:

> My recommendation was based on the fact that these are bundled services in an unbundled regulatory environment, and that the tariffs could be used to provide PECO Gas with an inequitable competitive advantage for gas supply. In addition, I observed that there was little customer interest in Rates MV-I and IS, and only modest interest in Rate TCS.[1651]

However, based upon the revised evidence presented in PECO's rebuttal testimony, Mr. Knecht concluded, as follows:

> Based on the Company's rebuttal GCOSS, the Company's forecast revenues for all three of these rate classes is sufficient to recover allocated costs (particularly for Rate TCS, which exhibits a very high rate of return).

* * *

[1650] OSBA St. No. 1, at 45-46.
[1651] OSBA St. No. 1-S, at 25.

> Thus, I continue to believe that these tariffs are anachronistic and have the potential to be anti-competitive. Nevertheless, I also recognize that, (a) overall, the proposed rates are forecast to produce revenues in excess of allocated cost, (b) the number of customers and load is relatively small, and (c) no competing natural gas suppliers have come forward to complain about anti-competitive rates. As such, the negative aspects of retaining the tariffs are likely to be minimal, and the Company could address the issue over a longer term.[1652]

OSBA MB at 27-28.

Therefore, in accordance with the testimony of Mr. Knecht, the OSBA recommends that, at a minimum, PECO address, in a future case, whether these customer classes should be eliminated from the Company's tariff. In the alternative, the Commission could reasonably determine that these tariff categories are anachronistic and anti-competitive, and that they should be phased out as soon as possible. OSBA MB at 28.

6. Rate L

The OSBA posits that if Rate L were a car, it would be an Edsel. PECO's tariff says that Rate L is "Large volume high load factor service for use in commercial and/or industrial applications, with the right reserved to restrict its use as a boiler fuel and for other non-critical use. This service shall be under a contract specifying in Mcf, the maximum daily quantity (MDQ) of natural gas to be supplied on a seasonal basis."[1653] By contrast, PECO's cost allocation analyst unabashedly asserts that the average load factor for this class is about 3.2 percent, and PECO's rate design experts fall over themselves trying to explain why this is somehow acceptable.[1654] OSBA MB at 28-29.

As Mr. Knecht explained at some length, Rate L currently has four "regular" Rate L customers, who presumably opted to take the service because it was designed for high load

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1652 OSBA St. No. 1-S, at 26.
1653 PECO Ex. JAB-2, page 60 of 83.
1654 OSBA St. No. 1, at 26; PECO St. No. 6-R, at 16 and No. 8-R, at 4-6.

factor customers. It is likely that Rate L used to have many such customers, but they have migrated elsewhere. OSBA MB at 29.

For its transportation service customers in Rate TS-F and TS-I, PECO offers a gas supply standby option. This is a *gas supply* rate option, not a base rates service. Nevertheless, for reasons that are far from clear, PECO requires that any transportation customer who takes the *gas supply* standby option to have that gas delivered under a regular service distribution tariff. Most of this gas is delivered in Rate L. PECO readily admits that it will charge such a customer a different rate if the Company provides the standby gas supply option rather than if a competitive NGS were to supply the gas.[1655] OSBA MB at 29.

The problem, of course, is that the standby supplies are a much larger contributor to Rate L class demand than are the demands of the regular customers.[1656] This situation produces the anomalous low load factor in a high load factor class, and it results in extremely costly service as measured by the GCOSS.[1657] Since the Company agreed to propose that tariff revenues for Rate L be moved into line with allocated cost for this class in this proceeding, it was obligated to propose a 387% increase for this class (511% for the commodity charge) in its rebuttal testimony.[1658] OSBA MB at 29-30.

The OSBA respectfully submits that there are two potential solutions to this problem: the "sensible way" and the "Company way." OSBA MB at 30.

The sensible way was explained by Mr. Knecht in his direct testimony. In that approach, Rate L service would be limited to regular high load factor customers as it was intended and designed. Transportation of PECO standby supply gas would be made using the transportation rates within the TS-F and TS-I tariffs, in the same way that NGS gas is delivered.[1659] Moreover, the OSBA observes that if the Company feels that the standby *gas*

[1655] OSBA St. No. 1, at 27.
[1656] PECO St. No. 6-R, at 17.
[1657] OSBA St. No. 1, at 34.
[1658] OSBA St. No. 1-S, at 24.
[1659] OSBA St. No. 1, at 52; OSBA St. No. 1-S, at 23.

supply rates not producing sufficient revenues to justify the standby *gas supply costs*, it should address that issue by proposing an alternative standby *gas supply* option in a Section 1307(f) proceeding. OSBA MB at 30.

Under OSBA's sensible way, and based on Mr. Knecht's cost allocation analysis, this approach would involve a zero increase to the regular Rate L customers in this proceeding. OSBA MB at 30.

The Company opposed Mr. Knecht's recommendation, generally because "we've always done it that way," "the customers are used to it," and of course, "our computer systems cannot handle any kind of change we don't feel like making."[1660] This then gives rise to the Company Way, which is to impose a massive rate increase on Rate L.[1661] This increase will, of course, cause the few remaining regular Rate L customers to switch to Rate GC or to transportation service. Moreover, the increase will likely cause transportation customers who use PECO's standby gas supply service to obtain standby supplies from NGSs, which can be delivered under the Rate TS-F and TS-I distribution charges.[1662] Ultimately, the Company Way will likely mean that Rate L will go unused. OSBA MB at 30-31.

The OSBA respectfully recommends that the Commission choose the sensible way. Consistent with the intent of gas supply competition, PECO should not be charging a different distribution rate if the customer chooses standby supplies from the utility rather than if the customer chooses standby supplies from competitive NGSs. Moreover, the intent of Rate L was to recognize that there are some high load factor customers that are less costly to serve, and the tariff provided a reasonable mechanism for doing so. Rate L would be preserved as a viable rate option under the Sensible Way, and it would effectively be killed under the Company way. OSBA MB at 31.

[1660] PECO Statement No. 8-R, at 4-6.
[1661] PECO Statement No. 7-R, at 12.
[1662] OSBA Statement No. 1-S, at 24-25.

iii. Distribution System Improvement Charge (DSIC) Cost Allocation

In Mr. Knecht's direct testimony, he expressed a concern that PECO allocated costs related to its distribution system improvement charge (DSIC) in such a way that the charges to Rate GC customers appeared to exceed the statutory cap of 5 percent, both historically and prospectively.[1663] PECO attempted to clear up the issue in their rebuttal testimony, as Mr. Knecht explained:

> As I understand his [PECO witness Mr. Bisti] rebuttal, he asserts that the Company's DSIC charges are, in fact, capped at 5 percent of the amount billed for distribution service for each rate class, but that the Company's budgeting process incorrectly allocated DSIC costs.
>
> Mr. Bisti claims that the budgeting process has been corrected and the effects reflected in Exhibit JAB-4 regarding current rates costs.
>
> For some classes, that statement appears to be correct. For others, specifically Rate OL, Rate L, Rate MV-I, Rate TS-F and Rate TS-I, it does not appear that the current-rates DSIC charge is five percent of the current base rates charges. As Mr. Bisti has not provided his calculations, I cannot determine whether the budgeting problem has been corrected.[[1664]]

Mr. Knecht continued, as follows:

> Nevertheless, based on Mr. Bisti's rebuttal testimony, my more serious concern, namely that the actual DSIC exceeded the five percent limit for individual rate classes, does not appear to be correct. The problem appears to have been limited to a budgeting error which did not affect actual DSIC charges.[[1665]]

OSBA MB at 31-32.

Therefore, with the Company's corrections set forth in its rebuttal testimony, the OSBA believes that DSIC allocation issue to be resolved. The OSBA trusts that the

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1663 OSBA Statement No. 1, at 46-48.
1664 OSBA Statement No. 1-S, at 18.
1665 *Id*.

Commission's audit staff will ensure that DSIC charges are, in fact, being imposed on the same percentage basis across all rate classes. OSBA MB at 32.

iv. Negotiated Gas Service

Pennsylvania NGDCs generally offer below-tariff negotiated rate options to their larger industrial customers who have competitive options, involving alternative fuels, bypass to interstate pipeline, or alternative business locations. Mr. Knecht explained that under very specific economic conditions these negotiated rates serve to benefit all ratepayers, and thus represent a useful device in the toolbox. OSBA MB at 32.

Unfortunately, this tool can easily be misused. Utilities may choose to offer discounted rates to large customers in order to maintain good working relationships or for political reasons, since the utilities' shareholders do not bear the costs. This problem becomes larger when the Commission adopts cost allocation policies that assign significant costs to larger industrial customers, such as the Commission's policy to exclude a customer component from the allocation of gas mains cost. Moreover, as the facts in this case demonstrate, a shift from an A&E allocation method to a P&A method for mains costs will likely serve to further increase the regular tariff rates for larger industrial customers. This change will then further increase the (politically powerful) demands from larger industrial customers for discounted negotiated rates. And we all know which class will bear any cost recovery shortfall from the large industrial customers. OSBA MB at 32-33.

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

> Below-tariff negotiated rates are justified in certain circumstances. Specifically, discounted rates can benefit all parties when (a) the rate is sufficient to recover all of the incremental cost of providing the service, and (b) the customer would refuse to take service at the regular tariff rate. Customers' reasons for refusing to take service

> can include a lower cost alternative fuel, a physical opportunity to bypass the distribution utility and take service directly from a pipeline or a producer, the opportunity to relocate the business to an alternative jurisdiction, or business shutdown. Meeting these criteria would justify a discounted rate, because retaining the customer revenues in excess of incremental costs reduces rates for all other customers. However, it is also important that the discounted rate charged to the customer be set at the maximum possible while remaining low enough to retain the customer. That is, simply because the customer has an alternative does not mean that the utility can reasonably offer an excessive rate discount.[1666]

OSBA MB at 33.

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

> I am advised by counsel that the Company has an obligation to demonstrate that its negotiated rates are justified by these circumstances. That is, the utility must show that a credible customer alternative exists, and the utility must show that it has evaluated the customer's cost for pursuing that alternative and has set the discount accordingly.
>
> Where the Company cannot demonstrate that it has met these conditions, the rates revenue for these customers should be based on the full tariff rates for the class.[1667]

OSBA MB at 33-34.

As the Commission appears to be pursuing a policy of substantially increasing costs assigned to larger customers, the OSBA strongly encourages the Commission to adopt strict policies and procedures regarding the use of negotiated rates for larger customers. This will preclude those larger customers and the utilities from doing an end-run around Commission cost allocation policy by the unfettered use of negotiated rates. OSBA MB at 34.

In this case, the Company offers negotiated rate service to six customers through Rate NGS, in some cases at a very large discount from regular rates. The OSBA respectfully

1666 OSBA Statement No. 1, at 39-40.

1667 OSBA Statement No. 1-S, at 40.

submits that the Company has not met its burden for five of these customers. These issues are addressed in detail based on data in Mr. Knecht's direct testimony and again in surrebuttal testimony.[1668] These confidential arguments are not repeated here. As demonstrated in that testimony, PECO has not met its burden with respect to negotiated rates for five of the six customers. The OSBA maintains that the Company's claimed revenue increase should be reduced by the amount of the unjustified rate discounts to these customers. OSBA MB at 34.

v. Theft/Fraud Investigation

The OSBA did not brief this issue.

e. Summary and Alternatives

The OSBA did not brief this issue.

5. CAUSE-PA's Position

a. Cost of Service

CAUSE-PA did not brief cost of service in this proceeding.

b. Revenue Allocation

CAUSE-PA did not brief any revenue allocation issues in this proceeding.

[1668] OSBA Statement No. 1, at 39-42; OSBA Statement No. 1-S, at 16-17.

c. Allocation of Universal Service Program Costs

i. The Commission Should Order PECO to Recover Universal Service Costs Equitably Across All Rate Classes

CAUSE-PA notes that the Commission declared in the *Final CAP Policy Statement Order* that it "will no longer routinely exempt non-residential classes from universal service obligations."[1669] In doing so, the Commission explicitly indicated that individual utility rate cases are the appropriate venue to consider recovery of the costs of CAP costs from all ratepayer classes.[1670] While the Commission did not order utilities to propose a specific allocation, it indicated that utilities should be prepared to address cross-class recovery of universal service costs in future rate case filings. However, in its current rate proposal, PECO has failed to present any proposal to address recovery of universal service costs across all rate classes. Currently, PECO recovers its universal service costs through its Universal Service Fund Charge, which is only included on residential customer bills.[1671] CAUSE-PA MB at 40-41.

Similar to the OCA, CAUSE-PA notes that the Commission, in explaining its rationale for amending the CAP Policy Statement to address the recovery of CAP costs, acknowledged that "poverty, poor housing stock, and other factors that contribute to households struggling to afford utility service are not just 'residential class' problems."[1672] As Mr. Miller explained in testimony:

> Energy insecurity impacts all customer classes (industry, business, commerce, educational institutions, hospitals, local and state governments, and other residential consumers) in specific and identifiable ways. The responsibility to provide universal access to life-sustaining utility service should be shared by all utility consumers. Poverty is a broad societal problem, impacting all customers and customer classes and requiring a collective, societal solution. While the most direct benefits of universal service programs are derived by program participants, who by definition are part of the residential customer class, there are a multitude of societal benefits which inure to non-residential ratepayers that

1669 *Final CAP Policy Statement and Order* at 7, 97; *see also* 52 Pa. Code §§ 69.625(1), 69.266(b).
1670 *Id.*
1671 Tariff at 36.
1672 *Final CAP Policy Statement and Order* at 94.

> should not be ignored. As a public good, the cost of ensuring affordable access to very basic human needs should be borne by all those who enjoy the benefits of the public utility.[1673]

CAUSE-PA MB at 41.

CAUSE-PA notes that the COVID-19 pandemic is pushing the number of low-income households in PECO's territory higher than it has ever been:

> Low-income workers are less likely to have paid sick leave or personal time to care for themselves or their families. Many low wage and hourly workers and are employed in the service, hospitality, and retail sectors, which have been especially hard hit by the emergency closure of non-essential businesses.[1674]

CAUSE-PA MB at 41-42.

As explained above, available data suggests that the pandemic is likely to lead to unprecedented levels of long-term unemployment for low wage workers, evictions, foreclosures, and utility terminations.[1675] The number of people who are out of work or who experience a reduction in available work or pay, will continue to grow as the pandemic continues, especially among low-wage workers who are most susceptible to pandemic related job losses.[1676] CAUSE-PA MB at 42.

Considering this growing need, it is not appropriate for PECO to continue to recover its universal service costs exclusively from the residential class. Energy insecurity impacts all customer classes and the responsibility to provide universal access to life-sustaining utility service should be shared by all utility consumers.[1677] Non-residential customers both contribute to the need for and benefit from the operation of PECO's universal service programs.[1678]

> While the most *direct* benefits of universal service programs are derived by program participants, who by definition are *part of* the

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1673 CAUSE-PA St. 1 at 49-50.
1674 CAUSE-PA St. 1 at 14
1675 CAUSE-PA St. 1 at 14-15
1676 *Id.*
1677 CAUSE-PA St. 1 at 49.
1678 *Id.* at 49-50.

> residential customer class, there are a multitude of societal benefits which inure to non-residential ratepayers that should not be ignored. As a public good, the cost of ensuring affordable access to very basic human needs should be borne by all those who enjoy the benefits of the public utility.[1679]

CAUSE-PA MB at 42.

CAUSE-PA argues that, in the context of this rate case, PECO failed to comply with the Commission's express instructions and stated expectation that utilities will address the issue of cross-class recovery of universal service costs in the context of its next rate case. As such, CAUSE-PA asserts that PECO should be ordered to develop a proposal to recover universal service program costs equitably from all ratepayers and seek approval for such a proposal within one year of a final order in this proceeding. CAUSE-PA MB at 42.

ii. Cross Class Recovery of Universal Service Costs is Consistent with Pennsylvania Law and Furthers Critically Important Public Policy Goals to Protect the Health and Safety of Vulnerable Pennsylvanians

CAUSE-PA points out that the Choice Act specifically authorizes the recovery of public purpose program costs, including universal service program costs, through a *nonbypassable* rate mechanism. Section 2203(6) of the Choice Act provides:

> After notice and hearings, the commission shall establish for each natural gas distribution company an appropriate nonbypassable, competitively neutral cost-recovery mechanism which is designed to recover fully the natural gas distribution company's universal service and energy conservation costs over the life of these programs.[1680]

Nothing in the Choice Act requires, encourages, or even suggests that the Commission should limit cost recovery of universal service programs to a specific rate class. Nor is there any provision which otherwise permits the Commission to allow a rate class to bypass universal service costs. To the contrary, the Choice Act is explicit that the Commission must ensure

[1679] *Id.*
[1680] 66 Pa. C.S. § 2203 (6).

universal service programs are "appropriately funded and available" to ensure that low-income customers can "maintain natural gas service" to their home.[1681] CAUSE-PA MB at 43.

As a matter of statutory interpretation, the Choice Act specifically prohibits recovery from the industrial customer for costs related to consumer education, indicating that the General Assembly clearly knows how to preclude cross class recovery when it believes such a restriction is appropriate.[1682] The absence of such a restriction for cross class recovery for universal service costs in the Choice Act is meaningful, and indicates the PUC has ample authority to approve cross-class recovery in its specific mandate to ensure that universal service programs are appropriately funded. As the Commission noted in its Final CAP Policy Statement, "there is no statutory or appellate prohibition that limits the recovery of CAP costs, whether specifically calculated or as part of total universal service costs, to funding from the residential class."[1683] CAUSE-PA MB at 43-44.

In August 2006, the Commonwealth Court in *Lloyd v. Pa. Pub. Util. Comm'n* addressed the right of Pennsylvania utilities to recover the costs of "public purpose programming" from all rate classes.[1684] In *Lloyd*, a challenge was brought by the PPL Industrial Customer Alliance (PPLICA) against the Commission's decision to allow cross-class recovery of funding for the Sustainable Energy Fund (SEF) in PPL's service territory. PPLICA argued that SEF provided "no demonstrable benefits to ratepayers" and asserted that there was no legal justification for funding the program through distribution rates.[1685] The Commonwealth Court roundly rejected PPLICA's arguments, finding explicitly that – through section 2802(17) of the Electric Choice Act[1686] – the General Assembly has specifically authorized that "public service programs" be funded through rates.[1687] The court stated:

[1681] 66 Pa. C.S. § 2202, 2203 (7), (8). Section 2202 defines "universal service and energy conservation" as the "[p]olicies, practices and services that help residential low-income retail gas … to maintain natural gas supply and distribution services. The term includes retail gas customer assistance programs…". 66 Pa. C.S § 2202.

[1682] 66 Pa. C.S. § 2206.

[1683] *Final CAP Policy Statement and Order* at 96.

[1684] *Lloyd v. Pa. Pub. Util. Comm'n*, 904 A.2d 1010 (Pa. Commw. Ct. 2006).

[1685] *Id.* at 1024-25.

[1686] Similar language is included in the Gas Choice Act. *See* 66 Pa. C.S. §§ 2202, 2203 (6)-(8).

[1687] *Lloyd v. Pa. PUC*, 904 A.2d at 1024-25.

> What the core of that argument ignores is that the General Assembly has specifically authorized that public service programs such as SEF be funded. Recognizing that certain programs funded under the utility monopoly and bundled rate regime were at risk once the electric industry was deregulated, it provided in the Competition Act that such funding be continued and that it be funded as an allowable expense by a 'nonbypassable rate mechanism.'[1688]

The Court also concluded that, "[I]t was well within the Commission's discretion to determine that SEF projects produced demonstrable benefits for ratepayers."[1689] Ultimately, pursuant to these findings, the Commonwealth Court affirmed the continued recovery of SEF program costs from all ratepayers, stating:

> Accordingly, based on the Commission's determination that SEF projects were a demonstrable benefit to distribution ratepayers**,** that the General Assembly authorized the continued funding, that SEF funding was not a tax, hidden or otherwise, but a conservation program directly related to conservation programs that the General Assembly permitted to be funded, the Commission's decision for continued funding of the SEF program is affirmed.[1690]

CAUSE-PA MB at 44-45.

It is clear that non-residential customers do indeed benefit from universal service programs in real and substantial ways.[1691] It is, therefore, only fair that they contribute to fund the programs. In analyzing the policy of Philadelphia Gas Works (PGW) to recover universal service costs across all customer classes, the Commission has acknowledged that commercial and industrial customers benefit from PGW's universal service programs.[1692] The Commission has also observed that "helping low-income families maintain utility service and remain in their homes is also a benefit to the economic climate of a community."[1693] Mr. Miller explained in testimony, "As a public good, the cost of ensuring affordable access to very basic human needs

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[1688] *Id.*
[1689] *Id.*
[1690] *Id.* (emphasis added).
[1691] CAUSE St. 1 at 49-53.
[1692] *Pa. Pub. Util. Comm'n v. PGW*, Docket No. R-2017-2586783, at 75 (Final order entered Nov. 8, 2017) ("We also find merit in the argument of the opposing Parties that all firm customers, including commercial and industrial customers, benefit indirectly from PGW's extensive low-income assistance programs.").
[1693] *Final CAP Policy Statement* at 94.

should be borne by all those who enjoy the benefits of the public utility."[1694] CAUSE-PA MB at 45.

Many universal service program participants are employed, but their employers do not pay enough to afford basic household need or are retired Seniors that do not receive enough in Social Security or retirement benefits to afford basic life necessities.[1695] In Pennsylvania, the majority (65.4%) of natural gas CAP customers received employment or retirement income, yet still could not afford basic living expenses without assistance.[1696] Poverty and energy insecurity can cause heightened levels of stress and anxiety and force employees to take time away from work address utility issues, which can significantly undermine worker productivity and increase employee turn-over and absenteeism.[1697] Thus, commercial employers contribute to the inability of their employees to afford utility service and these same employers benefit from the operation of the programs, which fill the gaps left by insufficient wages.[1698] It is thus inequitable for programs so essential to the public purpose goals of the Choice Act to continue to be funded solely by residential customers.[1699] CAUSE-PA MB at 45-46.

The effects of poverty on the healthcare system are especially profound and of particular concern in the COVID era. Data is emerging to show that the health impact and resulting loss of life is even more profound in low-income and minority communities. Mr. Miller explained in testimony:

> People of color in particular are dying from COVID-19 at younger ages and at higher rates. Low-income and minority communities are more likely to live near polluting industries, more likely to live in homes with mold and ventilation problems, and more likely to lack access to adequate health care – all of which are attributed to poorer health outcomes related to COVID-19 exposure. Energy insecurity is associated with poor respiratory outcomes including asthma and pneumonia, likely due to dampness, mold, and cold temperatures that can aggravate respiratory ailments. The

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1694 *See* CAUSE-PA St 1 at St. 1 at 50.

1695 CAUSE-PA St. 1 at 50.

1696 *Id*.

1697 *Id.*

1698 *Id*.

1699 66 Pa. C.S. § 2202 (indicating universal service and energy conservation programs should help residential low-income customers to "maintain natural gas supply and distribution services.").

> economic impact of COVID-19 is likewise more profound for low-income and minority communities. Comprehensive energy affordability programming, such as CAP and LIURP, can help alleviate the burdens that energy poverty creates on our healthcare system, providing broad benefits to all utility consumers and our economy overall.[1700]

CAUSE-PA MB at 46.

Universal service programming, such as CAP and LIURP help provide affordable service to low-income customers, which reduces the risk that they will forego food and medicine or keep homes at unsafe temperatures.[1701] Additionally, once the current moratorium on service terminations is lifted, these programs will be relied upon to help low-income customers maintain natural gas service. Continued access to natural gas service is vital in the face of the pandemic because it is necessary for hot water to wash and sanitize and heat for working/schooling from home; both of which are vital to helping curb the spread of disease, including COVID-19.[1702] Thus, universal service programs benefit all utility consumers and the economy by helping battle the pandemic by helping prevent further spread of COVID-19 in low-income and minority communities. CAUSE-PA MB at 47.

Another Philadelphia area natural gas utility, Philadelphia Gas Works (PGW) has a successful, long standing policy of recovering universal service costs across all customer classes. The Commission has observed: "*[W]e have not seen evidence that the economic climate in Philadelphia has been negatively impacted as a result of universal service costs charged by PGW*."[1703] As the record shows, other states that currently offer programs similar to Pennsylvania's universal service programs recover the costs of the programs across all rate classes.[1704] The Commission has acknowledged that "Cross-class recovery for universal service

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1700 *Id.* at 51-52.
1701 *Id*. at 21-30.
1702 *See Public Utility Service Termination Moratorium Proclamation of Disaster Emergency - COVID-19, Emergency Order*, Docket No. M-2020-3019244 (order entered Mar. 13, 2020).
1703 *Final CAP Policy Statement and Order* at 95-96.
1704 *See* CAUSE-PA St. 1 at 53; *See also, e.g.*, 4 CCR 723-3, § 3412(g) (Colorado); Ohio Rev. Code § 4928.52; NJ Rev. Stat. § 48:3-60; *Amendments to Consumer Protections Standards for Electric and Gas Transmission and Distribution Utilities (Chapter 815) and Statewide Low-income Assistance Plan (Chapter 314)*, No. 2013-00228, Order (Me P.U.C. July 17, 2013); *Re Statewide Low-Income Electric Assistance Program*, 87 NH PUC 349, 218 P.U.R.4th 442 (N.H. PUC 2002); *Order Adopting Low-income Program Modifications and Directing Utility Filings*,

costs is the 'norm' across much of the country, where state utility commissions and legislatures have expressly recognized that universally available utility services benefit the community as a whole."[1705]

> States recover the cost of utility low-income programs from all ratepayer classes, including New York, New Jersey, Ohio, Illinois, Maine, and New Hampshire [...]. We are not aware that this practice has negatively impacted the business climate of any these states.[1706]

CAUSE-PA MB at 47-48.

While residential consumers may exclusively experience energy poverty, they do not *cause* energy poverty nor do they exclusively experience its negative effects; thus, residential customers should not alone shoulder the cost of remediating the problem.[1707] Appropriate cost-sharing for these critical public purpose programs would lighten the burden on residential customers while providing more affordable service to CAP customers and more fairly allocate the costs of these critical programs between all of the entities who enjoy their benefits.[1708] CAUSE-PA MB at 48.

iii. The Current Gas Rate Case is the Appropriate Proceeding to Address Recovery of Gas CAP costs

In rebuttal testimony, PECO witness Kelly Colarelli opined that this gas rate case is not the appropriate place to consider cross-class allocation of universal service costs because PECO's gas-only CAP customers are only a small portion of its total CAP customers and PECO intends to address the allocation of universal service costs in its next electric base rate proceeding.[1709] However, as Mr. Miller pointed out in testimony, the fact that PECO's gas CAP

NY Pub. Service Comm'n Docket No. 14-M-0565 (May 20, 2016); 2015 ORS § 757.612(7); *Re Investigation into Percentage of Income Payment Program, No. 16-254, Order (Or. P.U.C. July 6, 2016);* Illinois Energy Assistance Act, 305 ILCS 20/18; Cal. Pub. Util. Code § 382.

1705 *Final CAP Policy Statement and Order* at 96.

1706 Final CAP Policy Statement and Order at 96.

1707 CAUSE-PA St. 1 at 52.

1708 *Id.* at 52-53.

1709 PECO St. 10-R at 12.

population is smaller than its electric CAP population "is not a valid reason to ignore equitable universal service cost allocation proposals in the context of its gas rate case, where determinations about the allocation of PECO's gas operations (including allocation of its gas-related universal service costs) are made."[1710] Mr. Miller explained:

> PECO has the highest number of residential gas customers in the state and the third highest number of gas CAP participants. The fact that PECO's gas operations are relatively smaller than PECO's electric operations does not excuse the Company from its obligation to appropriately allocate costs for its gas operations in the context of its gas rate case. The allocation of universal service costs incurred by its gas customers should be addressed here, in this proceeding, not in an electric rate case.[1711]

CAUSE-PA MB at 48-49.

As Mr. Miller points out, recovery of gas CAP costs must be addressed in a gas rate case, not an electric rate case.[1712] Thus, if PECO intends to address cross class recovery of its electric universal service costs in its next electric rate case, it should have addressed its gas universal service costs in the current proceeding. As such, CAUSE-PA submits that the Commission should require PECO to set forth a proposal to recover universal service costs equitably across all rate classes. CAUSE-PA MB at 49.

d. Tariff Structure

i. Residential Customer Charge

CAUSE-PA points out that most of the impact of the proposed rate increase for residential customers comes from this substantial increase to the fixed monthly service charge; thus, homes with the lowest usage levels will see the largest percentage increases, while homes with higher usage levels will see a lower percentage increase.[1713] CAUSE-PA MB at 49.

1710 CAUSE-PA St. 1-SR at 18.
1711 *Id.*
1712 *Id.*
1713 CAUSE-PA St. 1 at 7.

In testimony, CAUSE-PA witness Mitchell Miller recommended against PECO's proposal to increase its fixed residential customer charge.[1714] He recommended that if any increase in residential rate is approved, it should be applied exclusively to the volumetric charge.[1715] He explained that this approach would protect the ability of low income households to lower their bill by reducing consumption, which would, in turn, preserve the effectiveness of the LIURP program at reducing customer bills and improving payment behavior.[1716] CAUSE-PA MB at 49.

Mr. Miller explained, "Increasing the fixed charge as proposed will undermine the ability for consumers to control costs through energy efficiency, conservation, and consumption reduction, which is particularly problematic for low income customers."[1717] He explained that low income customers already struggle to pay for natural gas service, and rely on the ability to reduce bills through conservation and usage reduction: "Regardless of the level of household usage, any increase to the fixed charge prevents customers from exercising the ability to use conservation measures to mitigate that portion of the rate increase."[1718] CAUSE-PA MB at 50.

A primary reason for Mr. Miller's recommendation against increasing the fixed charge is the effect it would have on the efficacy of PECO's LIURP:

> PECO's proposal undermines the explicit goals of the Low-Income Usage Reduction Program (LIURP). The Commission's LIURP regulations explicitly provide that the program is intended to help low-income customers to reduce their *bills* and, in turn, to "decrease the incidence and risk of customer payment delinquencies and the attendant utility costs associated with uncollectible accounts expense, collection costs and arrearage carrying costs." By reducing the amount of bill reduction that can be obtained through LIURP measures, the proposed increase to the fixed charge threatens the continued effectiveness of ratepayer investments intended to reduce energy consumption, delinquencies, collections, and uncollectible costs. The explicit

1714 CAUSE-PA St. 1 at 32-35.
1715 *Id.* at 35.
1716 *Id.* at 35.
1717 CAUSE-PA St. 1 at 41.
1718 *Id.*

> goals of the program will be more difficult to achieve as the fixed portion of the bill is increased.[1719]

CAUSE-PA MB at 50.

Mr. Miller pointed out that LIURP has been effective at achieving these goals and producing meaningful average bill savings:

> In 2018, LIURP saved gas participants an average of $101 per year, or $8.41 per month. It also improved participants bill payment by 12.1%, or approximately $166 annually, and improved bill coverage by 4.6%. The ability to save money through energy efficiency, and therefore drive improved bill payment behavior, is tied directly to a bill structure that bases costs on throughput. But as more residential customer costs are shifted to the fixed charge, the achievable bill savings – and the corresponding impact on bill payment behavior – will erode.[1720]

CAUSE-PA MB at 50-51.

PECO's current customer charge is $11.75, which makes up 14.7% of the current average residential bill, which is $80.10.[1721] If the proposed fixed charge is approved at $16.00, it would equal 20% of the current average residential bill, which is $80.10 – or 18% of the average bill if PECO's rate increase is approved as requested, which would be $87.17.[1722] Thus, as Mr. Miller explained, "if the proposed increase in the fixed customer charge is approved, PECO's customers will lose the ability to control (on average) between 3-5% of their monthly bill through energy conservation and consumption reduction efforts –undermining the effectiveness of LIURP to achieve meaningful bill savings for low income consumers."[1723] CAUSE-PA MB at 51.

1719 CAUSE-PA St. 1 at 42. *Citing* 52 Pa. Code § 58.1 ("The programs are intended to assist low-income customers conserve energy and reduce residential energy bills. The reduction in energy bills should decrease the incidence and risk of customer payment delinquencies and the attendant utility costs associated with uncollectible accounts expense, collection costs and arrearage carrying costs.").

1720 CAUSE-PA St. 1 at 42.

1721 CAUSE-PA St. 1 at 43.

1722 *Id.*

1723 *Id.*

Low income households are disproportionately payment troubled, and often lack the ability to control usage due to poor housing stock and older, less efficient appliances; thus, it is critical that they continue to have access to effective conservation tools capable of producing meaningful and lasting bill reductions.[1724] The ability to achieve bill reduction through conservation measures is most critical for households with income above 150% FPL but less than 200% FPL because they are ineligible for CAP or LIHEAP, but are eligible for LIURP or the federal Weatherization Assistance Program (WAP).[1725] He explained that both of these programs have income guidelines that allow them to serve customers with income up to 200% FPL.[1726] Thus, as Mr. Miller explained, "It is critical that these households retain the ability to reduce their monthly energy costs through adoption of comprehensive energy efficiency and conservation programming."[1727] CAUSE-PA MB at 51.

Mr. Miller also explained that, in addition to undermining the effectiveness of millions of dollars in LIURP investments, PECO's high fixed charge proposal will also "undermine the millions of ratepayer dollars that the Company is proposing to invest in energy efficiency through its voluntary Energy Efficiency and Conservation Program Plan."[1728] CAUSE-PA MB at 51-52.

For these reasons, PECO's fixed monthly customer charges should not be increased and any approved increase in rates should be applied exclusively to the volumetric charge. This would protect the ability of low-income households to lower their utility costs by reducing consumption and would preserve the effectiveness of the LIURP program at reducing customer bills and improving payment behavior. CAUSE-PA MB at 52.

ii. Non-Residential Customer Rate Design

CAUSE-PA did not take a position on non-residential customer rate design in this proceeding.

1724 *Id.* at 43.
1725 *Id.*
1726 *Id.*
1727 *Id.*
1728 *Id.*

iii. Distribution System Improvement Charge (DSIC) Cost Allocation

CAUSE-PA did not take a position on DSIC Cost Allocation in this proceeding.

iv. Negotiated Gas Service

CAUSE-PA did not take a position on negotiated gas service in this proceeding.

v. Theft/Fraud Investigation

CAUSE-PA did not take a position on PECO's proposed theft/fraud investigation charge in this proceeding.

e. Summary and Alternatives

CAUSE-PA did not brief this issue.

6. PAIEUG's Position

a. Cost of Service

i. PECO's Class Cost of Service Study

PAIEUG supports the Company's COSS and agrees that it should be used to inform class revenue allocation in this proceeding.[1729] The purpose of a COSS is to assign a NGDC's revenue requirement to rate classes to cover the costs associated with the NGDC serving that rate class.[1730] As the "polestar" of utility ratemaking, cost of service provides the

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[1729] PAIEUG Statement No. 1, *Direct Testimony of Billie S. LaConte*, ("PAIEUG Statement No. 1"), pp. 3-4; *see also* PECO Exhibit JD-6R. After submitting Direct Testimony, PECO modified its original CCOSS and circulated its revised CCOSS to parties through discovery and with Rebuttal Testimony. References to PECO's CCOSS in this Main Brief are referring to PECO's revised CCOSS.

[1730] PAIEUG Statement No. 1, p. 3.

basis for allocating revenue to rate classes.[1731] Revenue allocation is not an exact science, which results in parties proposing different CCOSS approaches.[1732] The primary objective of a COSS, however, is to allocate costs in the manner they are incurred consistent with cost causation principles.[1733] PAIEUG MB at 10.

PAIEUG notes that as part of its Rebuttal Testimony, PECO submitted a revised COSS, which corrected an error related to each class's proposed relative rate of return ("ROR") within the original study.[1734] As part of the COSS, the Company: (a) determined the function of each component of its distribution system (*e.g.*, distribution, production, storage, commodity, meter, customer accounts, etc.); (b) classified the costs associated with each component based on how they are incurred (*e.g.*, capacity, customer-related, commodity, etc.); and, finally, (c) allocated the costs among the rate classes based on how each rate class contributes to those costs based on the demands, load profiles, and usage characteristics of the classes.[1735] PECO was able to directly assign some costs, including a small portion of mains costs, to the classes who are served by those mains and therefore, who caused the costs associated with those mains to be incurred. The vast majority of PECO's operating costs, however, are jointly incurred by multiple customer classes, and the CCOSS identifies how to apportion these costs among the different classes.[1736] PAIEUG reviewed PECO's revised COSS and generally agrees that PECO's approach was reasonable and consistent with cost causation principles.[1737] PAIEUG MB at 10-11.

Recognizing that PECO’s COSS classifies and allocates its distribution mains using the A&E methodology,[1738] PAIEUG notes that the A&E methodology uses a class's average demand (*i.e.*, average throughput) and a class's excess demand, which add together to equal the class's peak demand, to determine the appropriate class allocation of distribution main

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1731 *Lloyd v. Pa. Publ. Util. Comm'n*, 904 A.2d 1010, 1020 (Pa. Commw. Ct. 2006) (*Lloyd*).
1732 *Colorado Interstate Gas Co. v. Fed. Power Comm'n,* 324 U.S. 581, 589 (1945).
1733 *See id*.; see also Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp., Docket No. R-2010-2161694 (Opinion and Order dated October 15, 2010), p. 63; *see also Pa. Pub. Util. Comm'n v. Metro. Edison Co. and Pa. Elec. Co*., Docket Nos. R-00061366 and R-00061367 (Opinion and Order dated Jan. 11, 2007), p. 234.
1734 PECO Statement No. 6-R, *Rebuttal Testimony of Jiang Ding*, ("PECO Statement No. 6-R"), p. 3.
1735 PECO Statement No. 6, *Direct Testimony of Jiang Ding*, ("PECO Statement No. 6"), pp. 8-10.
1736 PECO Statement No. 6, p. 11.
1737 PAIEUG Statement No. 1, p. 3.
1738 PECO Statement No. 6, p. 13.

costs.[1739] Specifically, the percentage of mains equal to the system load factor is allocated based on average demand.[1740] The remaining mains are allocated based on excess demand, which represents the difference between peak demand and average demand.[1741] PAIEUG MB at 11.

PAIEUG submits that the A&E methodology is reasonable and consistent with cost causation principles because it aligns with the manner in which PECO designs its system and incurs distribution main costs. PAIEUG notes that the Company's distribution mains are "designed to meet system peak demands on a design day that all firm customers can be served."[1742] Although daily throughput often does not reach peak demand, the system must be designed and constructed as if peak demand could be reached on any given day.[1743] PECO only incurs distribution main-related costs when it needs to expand or upgrade the distribution system as a result of potential peak operating conditions.[1744] Therefore, peak demand is the driver of main costs, while average demand or throughput is simply a byproduct.[1745] Applying a weighting based on PECO's system load factor, which results in a higher percentage of mains being allocated based on excess demand and a lower percentage of mains being allocated based on average demand, recognizes that peak demand is the driver of main costs.[1746] Allocating main costs based on a class's contribution to peak demand (or average plus excess demand), including a system load factor weighting, is consistent with cost causation principles because main costs are being allocated based on how they are incurred by PECO. PAIEUG MB at 12.

The A&E methodology has been endorsed by the American Gas Association and the National Association of Regulatory Utility Commissioners (NARUC); is commonly used by

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1739 PECO Statement No. 6-R, p. 6.
1740 *Id.*
1741 *Id.*
1742 *See* PECO Statement No. 6-R, p. 7.
1743 PAIEUG Statement No. 1-R, *Rebuttal Testimony of Billie S. LaConte*, ("PAIEUG Statement No. 1-R"), p. 4.
1744 *See* PECO Statement No. 6-R, p. 7.
1745 *Id.*; *see also* PAIEUG Statement No. 1-R, p. 4.
1746 PAIEUG Statement No. 1-R, p. 4; *see also* PECO Statement No. 6-R, p. 7 ("It is inappropriate and in conflict with cost causation principles to treat the cost of excess capacity as an incremental cost instead of the primary cost driver.")

NGDCs in Pennsylvania; and has been approved by the PUC to allocate distribution mains.[1747] Similarly, PECO's use of system load factor as part of the A&E methodology for the weighting of average demand also represents common industry practice and is consistent with Commission precedent.[1748] PAIEUG MB at 12-13.

PAIEUG submits that in this proceeding, PAIEUG, I&E, and OSBA[1749] support PECO's CCOSS and PECO's use of an A&E methodology. Accordingly, the Commission should approve PECO's proposed A&E methodology because it is based on cost causation, aligns with how PECO designs and incurs costs related to its distribution system, and is consistent with Commission precedent and industry standards. PAIEUG MB at 13.

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

OCA is the only party to this proceeding that challenges PECO's use of the A&E methodology. OCA suggests that a different methodology, the peak and average (P&A) methodology be used instead of the A&E methodology, including a 50% weighting for the peak and average demand components.[1750] Given the united support for the A&E methodology among the other parties, OCA's proposed P&A methodology should be rejected. In addition, while OSBA agrees that the A&E methodology is reasonable, OSBA initially recommended that PECO apply a 50% weighting to average and excess demand rather than weighting based on

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[1747] PECO Statement No. 6-R, p. 6; PAIEUG Statement No. 1-R, pp. 4-5; *Pa Pub. Util. Comm'n v. PPL Gas Utils. Corp.*, Docket No. R-00061398 (Opinion and Order dated Feb. 8, 2007), pp. 176-178; *Pa Pub. Util. Comm'n v. Phila. Gas Works*, Docket No. R-00061931 (Opinion and Order dated Sept. 28, 2007); *see generally Pa Pub. Util. Comm'n v. PECO Energy Co.*, Docket No. R-2010-2161592 (Opinion and Order dated Dec. 16, 2010); *Pa Pub. Util. Comm'n v. Phila. Gas Works*, Docket No. R-2020-3017206 (Opinion and Order dated Nov. 19, 2020); *Pa Pub. Util. Comm'n v. UGI Central Penn Gas, Inc.*, Docket No. R-2010-2214415 (Recommended Decision dated Jul. 15, 2011).

[1748] PAIEUG Statement No. 1-R, pp. 4-5; *Pa Pub. Util. Comm'n v. PPL Gas Utils. Corp.*, Docket No. R-00061398 (Opinion and Order dated Feb. 8, 2007), p. 176 ("PPL Gas used and average and excess (A&E) method to allocate demand costs. The Company allocated 40% of demand costs based upon commodity usage and 60% based on excess demand (demand in excess of average demand) PPL Gas stated that the 40% for commodity was based upon system average load factors for 2004 and 2005 of 39.1% and 39.8% respectively….The excess demand was allocated using non-coincidental peak factors for each classification.").

[1749] As discussed further below, OSBA initially supports an A&E methodology using a 50% weighting, but in Surrebuttal Testimony, OSBA offers an alternative A&E methodology similar to PECO's. OSBA Statement No. 1-S, *Surrebuttal Testimony of Robert D. Knecht*, ("OSBA Statement No. 1-S"), p. 6.

[1750] OCA Statement No. 4, *Direct Testimony of Glenn A. Watkins* ("OCA Statement No. 1"), p. 21.

system load factor.[1751] For the following reasons, each of these proposals should be rejected in favor of the Company's proposed methodology. PAIEUG MB at 13.

The allocation of distribution mains is commonly the subject of debate in utility base rate proceedings because the chosen allocation methodology can have a significant impact on how costs are allocated among the classes. Although the A&E and the P&A methodologies are the only two methodologies at issue in this proceeding, a few other methodologies are also used to allocate distribution main costs. OCA identifies the customer/demand methodology, which evaluates both customer count and peak demand, as another allocation methodology used in the natural gas industry.[1752] A customer/demand methodology is different from the A&E and P&A models because it considers customer count by class when allocating distribution main costs rather than only considering class demand.[1753] Proponents of a customer/demand methodology argue that the methodology is reasonable because a portion of main costs are incurred per customer, such as the costs associated with connecting individual customers to the system.[1754] A customer/demand methodology often results in a lower revenue allocation to commercial and industrial classes, because there are fewer customers in those classes.[1755] PAIEUG MB at 14.

By contrast, the P&A methodology typically results in a lower revenue allocation for residential customers and a higher revenue allocation for industrial customers because it significantly relies on average demand, which is synonymous with average throughput, within the calculation.[1756] In fact, average demand is counted twice within the calculation: both for the average demand component of the calculation and within the peak demand component of the calculation again (since peak demand includes all average and excess demand for a particular class).[1757] Importantly, PECO does not design or incur costs related to its distribution system in response to average demand.[1758] Rather, PECO's system planning is driven by peak demand,

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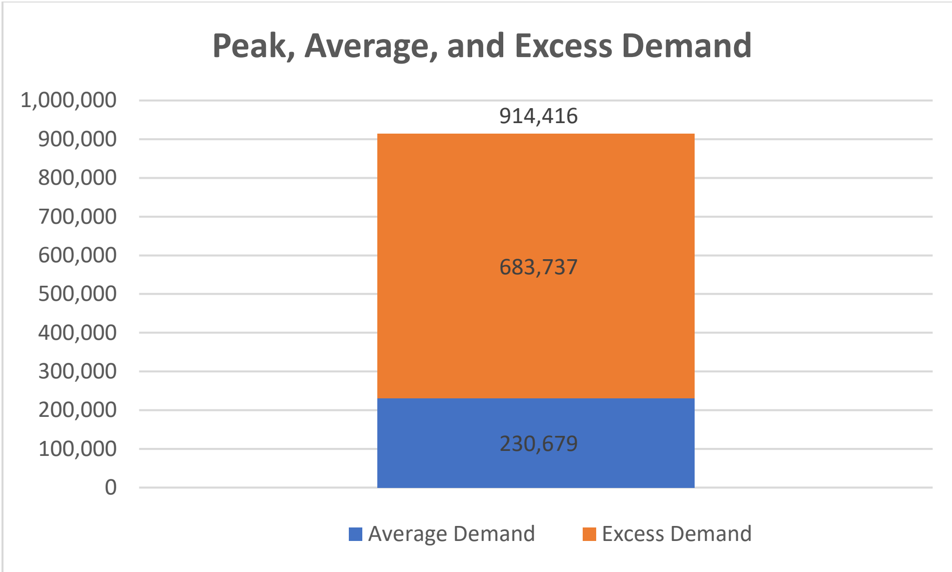
1751 OSBA Statement No. 1, p. 24.
1752 *Id.* at 6-7.
1753 *Id.*
1754 See *Id.*
1755 OSBA Statement No. 1-R, *Rebuttal Testimony of Robert D. Knecht*, ("OSBA Statement No. 1-R"), p. 6.
1756 *See* OSBA Statement No. 1, pp. 21-22.
1757 PAIEUG Statement No. 1-R, p. 6; *see also* PECO Statement No. 6-R, p. 8.
1758 PECO Statement No. 6-R, p. 7.

thereby rendering the P&A methodology inappropriate for purposes of this proceeding.[1759] PAIEUG MB at 14-15.

When comparing the A&E and P&A methodologies, PECO's proposed A&E methodology is the most reasonable solution because it is based most closely on PECO's cost causation and it has a balanced impact on customer classes. The Company's A&E methodology with a system load factor weighting recognizes that the primary driver of PECO's main costs is peak demand.[1760] Excess demand, which is calculated as the difference between peak and average demand, has a higher weighting than average demand because excess demand triggers whether PECO needs to construct or upgrade its distribution system.[1761] In addition, the P&A methodology (similar to the customer/demand methodology) is known to produce a more favorable result for certain classes as opposed to others.[1762] The A&E methodology avoids this class favoritism and offers the most balanced methodology for all customer classes consistent with cost causation principles. PAIEUG MB at 15.

Conversely, OCA is the only party to propose a P&A methodology in this proceeding. OCA's P&A methodology is problematic for two reasons: (1) it double counts average demand; and (2) it utilizes a 50% weighting of peak demand and average demand. With respect to the first issue, the P&A methodology significantly overemphasizes the importance of average demand by double counting average demand in both the average demand component of the calculation and the peak demand component of the calculation.[1763] The following chart demonstrates this phenomenon:

[1759] PECO Statement No. 6, p. 7; PAIEUG Statement No. 1-R, p. 4.
[1760] PECO Statement No. 6-R, p. 7.
[1761] *Id.* at 8; *see also* PAIEUG Statement No. 1-R, pp. 3-5.
[1762] *See* OSBA Statement No. 1, pp. 21-22; OSBA Statement No. 1-R, p. 6.
[1763] PAIEUG Statement No. 1-R, p. 6; *see also* PECO Statement No. 6-R, p. 8.



This chart reflects the peak, average, and excess demand information for the Company.[1764] As indicated by this chart, if, as proposed by OCA, 50% of main costs are allocated based on peak demand and the other 50% of main costs are allocated based on average demand, the peak demand calculation will include all of the average demand as well resulting in a double counting of average demand.[1765] By not subtracting average demand from peak demand for this calculation, OCA is significantly overweighting its methodology in favor of low load factor customers like residential customers.[1766] The A&E methodology avoids this double counting because it applies the percentage of mains equal to the system load factor to average demand and the remaining percentage of mains to excess demand.[1767] Because excess demand specifically subtracts average demand from peak demand, no double counting of average demand occurs as part of the A&E methodology.[1768] PAIEUG MB at 15-16.

Regarding the second issue, the OCA proposes to use an inappropriate 50% weighting of peak demand and average demand. In order to reflect cost causation, the allocation methodology must use a system load factor weighting rather than weighting average and excess (or peak) demand equally as proposed by OCA. Preliminarily, NARUC has explained that an

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1764 PECO Exhibit JD-6R; *see also* PAIEUG Statement No. 1-R, p. 6.
1765 PAIEUG Statement No. 1-R, p. 6.
1766 OSBA Statement No. 1-R, p. 7.
1767 PAIEUG Statement No. 1-R, p. 6.
1768 *Id.*

NGDC's system load factor should be used as the weighting for either the A&E or the P&A methodology.[1769] PECO's system load factor weighting creates a higher weighting for excess demand, which represents the difference between a class's peak and average demand, and a lower weighting for average demand, which is appropriate and consistent with cost causation principles because peak demand is what causes PECO to incur additional main costs.[1770] PAIEUG MB at 17.

OCA proposes a 50% weighting as part of its proposed CCOSS methodology, giving equal weight to average demand and peak demand.[1771] OCA argues that PECO's system is designed to meet both annual demand and peak demand,[1772] which is clearly contradicted by the evidentiary record. PECO evaluates peak demand, rather than annual throughput, when considering system projects.[1773] PECO's list of factors for sizing mains includes "projected customer demand on a design day for the distribution system," and has no reference to average demand at all.[1774] As a result, giving average demand an equal weighting to excess demand would be arbitrary with no basis in cost causation.[1775] PAIEUG MB at 17.

OCA further submits that average demand should have an equal weighting to peak demand because, as the size of mains increase to serve peak demand, the corresponding cost increases at a decreased rate.[1776] In other words, according to the OCA, there are economies of scale created when constructing a new main and an equal weighting of peak and average demand would reflect this reality.[1777] PECO refutes this argument, however, explaining that, as main size increases, different main materials and labor may be required that could significantly increase the price point of serving peak demand.[1778] Either way, excess demand must have a higher weighting than average demand because it reflects how costs are incurred by PECO.[1779]

1769 PAIEUG Statement No. 1-R, pp. 5-6.
1770 PECO Statement No. 6-R, p. 7; PAIEUG Statement No. 1-R, pp. 3-5.
1771 OCA Statement No. 4, p. 21.
1772 *Id.* at 12.
1773 PECO Statement No. 6-R, p. 7.
1774 PAIEUG Statement No. 1-R, pp. 5-6.
1775 PAIEUG Statement No. 1-R, p. 3.
1776 OCA Statement No. 4, p. 16.
1777 *Id.* at 16-17.
1778 PECO Statement No. 6-R, p. 7.
1779 PECO Statement No. 6-R, p. 7; PAIEUG Statement No. 1-R, pp. 3-5.

Even if the system experiences average demand the majority of the time, PECO must construct its system to serve the peak demand of all customer classes.[1780] Peak demand drives main costs, and the portion of demand related to the peak should be weighted higher in the allocation methodology to reflect cost causation. PAIEUG MB at 17-18.

Although OSBA agrees that a 50% weighting is arbitrary, OSBA initially proposes a 50% weighting for the A&E methodology because OSBA claims it is trying to adhere to Commission precedent.[1781] In a prior Philadelphia Gas Works' ("PGW") base rate proceeding, the Commission held that both annual and peak demand should be included in PGW's allocation methodology.[1782] OSBA believes that an A&E methodology using a system load factor weighting only considers peak demand, which, in OSBA's view, would be contrary to this PGW decision.[1783] However, in another previous Commission decision related to PPL Gas Utilities Corporation, the Commission approved an A&E methodology using system load factor weighting.[1784] Therefore, PECO's proposed A&E methodology using system load factor weighting is consistent with Commission precedent as well. Ultimately, in Surrebuttal Testimony, OSBA proposes an alternate CCOSS also using an A&E methodology with system load factor weighting for the Commission's consideration.[1785] By doing so, OSBA is recognizing that PECO's proposed methodology is just and reasonable. PAIEUG MB at 18-19.

Although the Commission approved the P&A methodology as part of Columbia's recent base rate proceeding, distinguishing factors warrant a different result in this proceeding.[1786] In *Columbia*, the Commission specifically found that no party presented the A&E methodology for the Commission's consideration.[1787] Instead, the Commission was required to decide among a customer/demand methodology, a P&A methodology, and an

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1780 *See* OSBA Statement No. 1-R, pp. 6-7.
1781 OSBA Statement No. 1-S, pp. 5-6.
1782 *See id.*; *see also Pa Pub. Util. Comm'n v. Phila. Gas Works*, Docket No. R-00061931 (Opinion and Order dated Sept. 28, 2007), pp. 123-124.
1783 OSBA Statement No. 1-S, pp. 5-6.
1784 *Pa Pub. Util. Comm'n v. PPL Gas Utils. Corp.*, Docket No. R-00061398 (Opinion and Order dated Feb. 8, 2007), p. 176.
1785 OSBA Statement No. 1-S, p. 6.
1786 *Columbia* at 214.
1787 *Id*.

average of the two.[1788] Without being able to compare the A&E methodology to the P&A methodology in *Columbia*, the Commission did not have an opportunity to evaluate whether the A&E methodology is reasonable and consistent with cost causation principles. PAIEUG MB at 19.

In addition, PECO presented clear record evidence that, based on its system planning, the primary driver of its main costs is peak demand.[1789] By allocating a larger portion of main costs to excess demand and a smaller portion of main costs to average demand through the A&E methodology, PECO is recognizing that peak demand is the primary driver of main costs consistent with cost causation principles.[1790] Because a different proposed allocation methodology and evidentiary record exist in this case, the Commission's recent order in *Columbia* does not prevent the Commission from approving the use of the A&E methodology in this proceeding. PAIEUG MB at 19-20.

PAIEUG argues the Commission should approve PECO's proposed A&E methodology because it results in the most reasonable allocation of distribution main costs among customer classes consistent with cost causation principles on PECO's system. The A&E methodology avoids double counting of average demand and complements PECO's system planning procedures. PECO's weighting based on system load factor appropriately recognizes that peak demand is the primary driver of main costs. The A&E methodology including a system load factor weighting is recognized within the natural gas industry as a reasonable allocation methodology for distribution mains and consistent with Commission precedent. Accordingly, PECO's proposed CCOSS, including its proposed methodology for the allocation of distribution main costs, should be approved by the Commission. PAIEUG MB at 20.

iii. Other Cost of Service Issues

PAIEUG did not brief other cost of service issues.

1788 *Id.* at 215.
1789 PECO Statement No. 6-R, p. 7.
1790 *Id.* at 8.

b. Revenue Allocation

i. PECO's Revised Revenue Allocation

In the Company's initial filing, PECO's original revenue allocation included several errors: (1) PECO overstated the calculated RORs from the classes that are currently below cost and understated the RORs from classes currently above cost; (2) PECO moved all classes away from their cost of service; (3) PECO proposed revenue increases that were inappropriate based on these classes' relative RORs; and (4) PECO's methodology did not consider gradualism.[1791] All parties pointed out these issues in their Direct Testimony, and PECO proposed a revised revenue allocation in Rebuttal Testimony. PECO's revised revenue allocation is more reasonable, but still requires further adjustment because PECO is proposing to significantly increase the distribution rate for Rate TS-F, a rate class which is already paying above its cost of service. This element of PECO's revised revenue allocation violates Section 1304 of the Public Utility Code and related precedent. PAIEUG MB at 20-21.

The Public Utility Code, Commonwealth Court precedent, and Commission precedent establish several requirements for revenue allocation. Pursuant to Section 1304 of the Public Utility Code, NGDCs have an overarching obligation not to "establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service."[1792] In order to survive a challenge under Section 1304 of the Public Utility Code, the Commonwealth Court held that a "utility must show that the differential can be justified by the difference in costs required to deliver service to each class."[1793] For a revenue allocation to be found reasonable, Commission precedent further explains that the revenue allocation should move all rate classes closer to the system average ROR, *i.e.*, closer to their cost of service, while also recognizing principles of gradualism.[1794] Principles of gradualism require "phasing in rates or closing rate differentials over a longer period of time allowing consumers to gradually make

[1791] PAIEUG Statement No. 1, pp. 5, 8, 9, 11.
[1792] 66 Pa. C.S. § 1304.
[1793] *Phila. Suburban Water Co. v. Pa. Pub. Util. Comm'n*, 808 A.2d 1044, 1060 (Pa. Commw. Ct. 2002); see also Lloyd at 1016.
[1794] *Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp.,* Docket No. R-2012-2290597 (Opinion and Order dated Dec. 28, 2012), pp. 118-119 (Dec. 28, 2012).

the adjustments in the 'elastic' part of their spending so as to pay for increased utility costs."[1795] While principles of gradualism should be considered, they "do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time."[1796] PAIEUG MB at 21.

PECO's proposed revenue allocation does not survive a challenge under Section 1304 of the Public Utility Code.[1797] Although PECO's revised revenue allocation resolves many of the errors from its original allocation, PECO is proposing a substantially above average rate increase for Rate TS-F, even though this class is already paying an above system average relative ROR.[1798] By doing so, Rate TS-F is the only class with an above system average relative ROR that would receive an above system average rate increase.[1799] PAIEUG MB at 22.

PECO offers no cost-based rationale for its proposed allocation to Rate TS-F.[1800] Rather, PECO appears to have arbitrarily chosen Rate TS-F to be allocated the additional dollars necessary to reach PECO's proposed revenue requirement. By singling out Rate TS-F in this manner without offering any cost-based justification for the rate increase, PECO's proposed revenue allocation violates Section 1304 of the Public Utility Code and related Commission precedent. PAIEUG MB at 22.

Other than PECO's proposed increase for Rate TS-F, however, PAIEUG generally agrees with PECO's revised revenue allocation. PECO moves all classes closer to their cost of service other than Rate TS-F.[1801] PECO also proposes to eliminate the difference between the system average ROR and the class ROR for Rate GC and Rate L, which effectively moves the rates for these classes to their cost of service.[1802] As part of PECO's 2008 base rate settlement,

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1795 *Lloyd* at fn. 14.
1796 *Lloyd* at 1020.
1797 66 Pa. C.S. § 1304. PECO significantly modified its proposed revenue allocation in Rebuttal Testimony. *See* PECO JAB-1 Revised.
1798 PECO Statement No. 7-R, p. 5; PAIEUG Statement No. 1-S, *Surrebuttal Testimony of Billie S. LaConte*, ("PAIEUG Statement No. 1-S"), pp. 3-4.
1799 PAIEUG Statement No. 1-S, pp. 3-4.
1800 *See* OSBA Statement No. 1-S, p. 12.
1801 PECO Statement No. 7-R, p. 5.
1802 PECO Statement No. 7-R, pp. 4-5.

PECO agreed to adopt this change over the course of its next two base rate cases.[1803] Because this is PECO's second base rate case since making that commitment, PECO was required to propose to move these classes to cost in this proceeding to comply with the 2008 settlement.[1804] PAIEUG MB at 22-23.

PAIEUG agrees that PECO should be bound by the terms of its prior settlement, which was approved by the Commission. Although the proposed rate increase and decrease for Rates L and GC may appear substantial, cost of service, rather than gradualism, remains the most important factor in any revenue allocation.[1805] Under Commonwealth Court precedent, principles of gradualism "do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time."[1806] If Rates GC and L are not moved to the system average ROR in this proceeding, the prolonged cross-subsidization that has existed since PECO's 2008 rate case will continue. To adhere to Commonwealth Court precedent, Rates GC and L must move to their cost of service in this proceeding without regard for principles of gradualism.[1807] PAIEUG MB at 23.

Accordingly, PAIEUG maintains that PECO's revised revenue allocation would be reasonable, except for the unjustified rate increase imposed upon Rate TS-F customers, which violates Section 1304 of the Public Utility Code. For this reason, the Commission should order PECO to modify its revenue allocation to reduce the rate increase imposed on Rate TS-F. PAIEUG MB at 23.

ii. Opposing Party Alternative Revenue Allocations

PAIEUG maintains that the Commission should adopt PAIEUG's proposed revenue allocation, which it argues is consistent with the Public Utility Code, Commonwealth

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1803 PECO Statement No. 7-R, p. 12; *Pa. Pub. Util. Comm'n v. PECO Energy Co.*, Docket No. R-2008-2028394 (Joint Petition for Settlement dated Aug. 21, 2008), pp. 5-6.

1804 *See id*.

1805 *See id*.

1806 *Lloyd* at 1020.

1807 *Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp.,* Docket No. R-2012-2290597 (Opinion and Order dated Dec. 28, 2012), pp. 118-119 (Dec. 28, 2012).

Court and Commission precedent, and adheres to principles of cost causation and gradualism. PAIEUG's proposed revenue allocation moves all classes closer to the system average ROR while also acknowledging principles of gradualism.[1808] PAIEUG notes that its proposed revenue allocation offers the most equitable solution for all classes as compared to other parties' proposed revenue allocations in this proceeding. PAIEUG MB at 24.

PAIEUG's proposed revenue allocation is illustrated as follows:[1809]

PECO ENERGY COMPANY
PAIEUG Recommended Class Revenue Allocation
For the Fully Projected Future Test Year Ended June 30, 2022
(Dollar Amounts in Thousands)

			Target Increase				PAIEUG Recommended Rates		
Line	Rate Class	Present RROR	Percent	Amount	Adjusted Delivery Revenues	Gross Revenue Conversion Factor	Operating Income	Rate of Return	Relative ROR
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Residential	0.83	28.0%	$65,658	$300,152	1.41376	$126,760	7.50%	0.99
2	General Service	1.40	-4.0%	(3,969)	96,061	1.41376	45,309	7.58%	1.00
3	Large High Load Factor	(0.36)	389.8%	293	368	1.41376	163	7.67%	1.01
4	Motor Vehicle Service Firm	2.13	-24.5%	(115)	355	1.41376	170	8.28%	1.09
5	Motor Vehicle Service Interruptible	3.48	-19.4%	(1)	2	1.41376	2	7.64%	1.01
6	Interruptible Service	1.62	-5.5%	(2)	33	1.41376	16	8.55%	1.13
7	Temperature Controlled Service	7.51	-75.4%	(514)	168	1.41376	111	10.06%	1.33
8	Gas Transportation Firm	1.17	15.3%	2,536	19,101	1.41376	9,590	8.23%	1.09
9	Gas Transportation Interruptible	1.47	-0.5%	(45)	9,216	1.41376	4,432	8.37%	1.10
10	Total Gas Division	1.00	17.8%	$63,842	$425,456	1.41376	$186,552	7.57%	1.00

PAIEUG MB at 24.

Recognizing that Rate TS-F is already paying above the system average ROR, PAIEUG is proposing a below system average increase for this class.[1810] In addition, PAIEUG moves Rates GC and L to the system average ROR consistent with PECO's settlement obligations and corresponding Commission precedent.[1811] To comport with principles of gradualism, PAIEUG capped the increase to all other classes at no more than 1.5 times the

[1808] PAIEUG Statement No. 1-S, p. 5.
[1809] PAIEUG Exhibit BSL-1S.
[1810] PAIEUG Statement No. 1-S, p. 5.
[1811] *Id.*

system average increase.[1812] Finally and most importantly, under PAIEUG's proposed allocation, all classes are moving towards the system average ROR consistent with Commonwealth and Commission precedent.[1813] PAIEUG MB at 24-25.

It is PAIEUG's position that the most reasonable path forward for the Commission is to adopt PAIEUG's proposed revenue allocation, under which: (a) all customer classes move closer to the system average ROR; (b) PECO adheres to its settlement commitments related to Rates GC and L as approved by the Commission; and (c) principles of gradualism are applied for all other customer classes. The Commission's adherence to principles of cost causation is even more necessary due to the economic hardships presented to all customers from the COVID-19 pandemic. To ensure that rates are increased in an equitable and non-discriminatory manner, no customer class should be moved away from its cost of service in this proceeding. For these reasons, PAIEUG's proposed revenue allocation methodology should be adopted by the Commission. PAIEUG MB at 27.

iii. Scale Back of Rates

If the Commission approves a lower revenue increase for PECO than requested, PAEIUG recommends a proportional scale back of rates for all customer classes, in which the proposed rate changes would be reduced proportionally to the overall reduction in PECO's revenue increase.[1814] In other words, if the Commission determines that a specific revenue allocation is reasonable, that same allocation should be applied whether or not PECO is authorized its full revenue increase. In that instance, a proportional scale back based on PAIEUG's proposed revenue allocation is reasonable and consistent with Commission precedent.[1815] PAIEUG MB at 28.

[1812] *Id.*; *see also Columbia* at 233 ("The record indicates that although there are no definitive rules for determining what kind of rate increase would violate the principle of gradualism, limiting the maximum average rate increase for any particular class to 1.5 to 2.0 times the system average increase is one common metric that has been used by experts in the Commonwealth.")

[1813] *Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp.,* Docket No. R-2012-2290597 (Opinion and Order dated Dec. 28, 2012), pp. 118-119 (Dec. 28, 2012); *see also Lloyd* at 1020.

[1814] PAIEUG Statement No. 1-S, p. 11.

[1815] *Columbia* at 234; *see also Pa. Pub. Util. Comm'n v. UGI Utils., Inc.,* Docket No. R-00932862 (Opinion and Order dated May 23, 1994), pp. 128-129.

PECO, OCA, and I&E all propose proportional scale backs with limited exceptions. PECO proposes a proportional scale back of revenue increases among the classes with the exclusion of customer charges.[1816] OCA recommends a proportional scale back with the exception of Rates GC, OL, MV-I, and TCS, because OCA is proposing no rate increases for those classes.[1817] I&E proposes a proportional scale back for all classes that receive an increase.[1818] Further, I&E disagrees with the Company's proposal to leave customer charges out of any scale back.[1819] PAIEUG MB at 28.

OSBA's proposal is significantly different from the typical proportional scale back approach. OSBA proposes a hybrid approach that factors in both the share of the proposed increase and the share of revenues for each class to determine a list of class-specific scale back percentages.[1820] OSBA proposes this approach in an effort to ensure classes receiving rate decreases, such as Rate GC, can benefit from any scale back, which in this proceeding could be significant.[1821] PAIEUG MB at 28-29.

Given the significant divergence of OSBA's proposal from Commission precedent and other parties' proposals, significant concerns arise with this approach. The remaining parties generally agree that a proportional scale back is appropriate where a customer class would receive a revenue increase under the revenue allocation methodology adopted by the Commission. For any classes receiving a revenue decrease, those decreases could remain the same in any scale back. PAIEUG MB at 29.

Alternatively, the scale back could be applied to each class's adjusted delivery revenues, which would include all classes in the scale back, even those who receive no increase or decreases.[1822] Because the Company does not offer any justification for excluding customer

[1816] PECO Statement No. 7-R, p. 6.
[1817] OCA Statement No. 4, p. 29.
[1818] I&E Statement No. 3-S, p. 26.
[1819] *Id.*
[1820] OSBA Statement No. 1-R, pp. 19-20.
[1821] *Id.*
[1822] PAIEUG Statement No. 1-S, p. 11.

charges from the scale back, PAIEUG recommends including customer charges in any scale back approved by the Commission. PAIEUG MB at 29.

Accordingly, consistent with Commission precedent, if the Commission does not approve PECO's full revenue increase, PAIEUG submits that a proportional scale back of rates based upon PAIEUG's proposed revenue allocation should occur as described herein. Moreover, this scaleback should apply to both volumetric charges and customer charges. PAIEUG MB at 29.

c. Allocation of Universal Service Program Costs

PAIEUG points out that PECO's Universal Service Programs (USP) are funded by the residential customer class, as only this class of customers is eligible to participate in the Company's low-income assistance programs.[1823] Although PECO did not propose to change the manner in which these programs are funded for purposes of this proceeding, CAUSE-PA and OCA seek to expand the allocation of USP costs to all rate classes.[1824] As discussed more fully herein, because allocating USP costs to non-residential classes violates cost-causation principles, does not provide any direct benefit for non-residential classes, compounds the economic hardships commercial and industrial customers are experiencing due to the COVID-19 pandemic, and ignores recent PUC precedent, the Commission must reject CAUSE-PA's and OCA's proposal. Instead, the Commission should maintain the status quo with respect to USP cost allocation on PECO's system. PAIEUG MB at 29-30.

Expanding the allocation of USP costs to all customer classes would ignore the well-established principles of cost-causation. The Commonwealth Court of Pennsylvania has previously indicated that the principle of cost causation is the polestar for ratemaking purposes.[1825] Adherence to the principles of cost-causation means that only those customers who

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1823 PECO Statement No. 10-R, *Rebuttal Testimony of Kelly Colarelli* ("PECO Statement No. 10-R"), p. 12.

1824 *Id.;* OCA Statement No. 5, *Direct Testimony of Roger D. Colton* ("OCA Statement No. 5"), pp. 71-90; CAUSE-PA Statement No.1, *Direct Testimony of Mitchell Miller* ("CAUSE-PA Statement No. 1"), pp. 48-54.

1825 *Lloyd* at 1016.

benefit from and are eligible for certain programs should fund such programs.[1826] In fashioning the proper cost allocation for PECO's USP, the Commission must consider the purpose of the program. In this instance, the Company's USP are "a cost incurred to serve [the residential] class,"[1827] as, under PECO's Tariff, the residential customer class is the only class that can receive assistance from the Company's low-income programs.[1828] Therefore, allocating USP costs to all customer classes would be "contrary to the Commission's cost-of-service philosophy."[1829] PAIEUG MB at 30.

PAIEUG asserts that in an effort to expand cost causation principles to fit their claims, OCA and CAUSE-PA inappropriately argue that PECO's USP provides an indirect benefit to non-residential classes.[1830] In order to fully understand this claim, the PUC must consider the two different models that can be used for recovery of low-income assistance program costs.[1831] The first model, of which PAIEUG is a proponent, is the insurance model, in which USP in general, are said to be a "form of insurance, in which residential gas customers are paying premiums to the utility so that they will be eligible for cash benefits in the event they have an unfortunate turn in their economic circumstances."[1832] PECO's current collection of USP costs from only the residential customer class adheres to this model. PAIEUG MB at 30-31.

The second model is the government/public policy tax model, which is based on the contention that society benefits indirectly from assisting low-income residents.[1833] By proposing to expand the allocation of USP costs to all customer classes, OCA and CAUSE-PA seek to advance the public policy tax model. This model contends that, because society *indirectly* benefits from low-income assistance programs, such cost should be spread to those that do not directly benefit. Such a taxation model, however, would be exceedingly difficult to

1826 OSBA Statement No. 1-R, p. 24.
1827 PAIEUG Statement No. 1-R, p. 12.
1828 *Id.*; *see also* OSBA Statement No. 1-R, p. 24.
1829 PAIEUG Statement No. 1-R, p. 12.
1830 OCA Statement No. 5, pp. 71-90; CAUSE-PA Statement No. 1, pp. 48-54.
1831 OSBA Statement No. 1-R, p. 23.
1832 *Id.*
1833 *Id.*

implement in a way that acknowledges indirect benefits received through USP.[1834] Under the public policy tax model, all customers in PECO's service territory would receive an indirect benefit, regardless of whether the customers actually use these programs; whereas, in the insurance model, residential customers pay for the programs and benefit from these programs should the need arise.[1835] Because the insurance model adheres to cost-causation principles, the PUC should continue to utilize this model and maintain the status quo for collection of USP costs on PECO's system. PAIEUG MB at 31.

In addition, applying the public or societal benefit concept from the public policy tax model would cause confusion and unnecessary complexity in regulatory matters.[1836] If the Commission were to allocate USP costs on the amorphous basis of a public or societal benefit, future proceedings could find numerous parties requesting discounts, subsidies, credits, or free service based upon the same public benefits offered.[1837] In the end, because even businesses provide societal benefits through wages, no funding source will exist for all of the free service given for alleged public benefits. Because of the slippery slope that could result from the use of the second tax model, the Commission should continue to apply the insurance model in the instant case.[1838] PAIEUG MB at 31-32.

Further, PAIEUG argues that even if the Commission were to consider OCA's and CAUSE-PA's claim of a "public benefit" for purposes of cost causation, no such public benefit can be found, especially in light of the hardships currently faced by Large C&I customers due to the COVID-19 pandemic.[1839] For example, many Large C&I customers are experiencing significant reductions in revenues due to the COVID-19 outbreak, including hospitals, which are overwhelmed with patients due to COVID-19 and are unable to perform high-end elective procedures, which are more profitable.[1840] As a result, shifting costs for the USP to rate classes that inure no benefit from the program "would result in unnecessary and inappropriate

[1834] OSBA Statement No. 1-R, p. 24.
[1835] *Id*.
[1836] *Id*.
[1837] *Id*.
[1838] *Id*.
[1839] PAIEUG Statement No. 1-R, pp. 12-13.
[1840] *Id*.

subsidies," which would be "counterproductive, particularly during the current pandemic."[1841] PAIEUG MB at 32.

In an effort to further justify their proposal, CAUSE-PA and OCA rely on the Commission's *Final CAP Policy Statement*.[1842] Specifically, OCA and CAUSE-PA claim that the Commission's statements indicating a willingness to consider arguments to include non-residential classes in the allocation of USP costs translates to the PUC's automatic support to change PECO's USP cost allocation.[1843] However, in *Columbia*, where OCA and CAUSE-PA made similar arguments, the Commission not only maintained the status quo of cost allocation for Columbia's universal service program but also noted the non-precedential nature of the *Final CAP Policy Statement*.[1844] PAIEUG MB at 32-33.

In *Columbia Gas*, the Commission acknowledged that the historical approach to approving recovery of UPS costs was based on the narrowly tailored nature of these programs and the potential negative impact on Pennsylvania's businesses if these costs were recovered from all ratepayer classes.[1845] In the *Final CAP Policy Statement*, noting the burden that current cost recovery methods tend to place on residential customer bills, the PUC deemed it necessary to revise its approach to no longer "routinely exempt non-residential classes from universal service obligations."[1846] However, "while [the Commission] stated that [Customer Assistance Program] cost recovery from all ratepayer classes should be *considered* in rate cases" the Commission was also careful to note that it was "not making a precedential decision concerning cost recovery within the Final CAP Policy Statement Order."[1847] PAIEUG MB at 33.

Accordingly, the Commission considered USP cost allocation in *Columbia* based on "the substantial evidence in the record and whether or not the OCA and CAUSE-PA have

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[1841] PAIEUG Statement No. 1-R, p. 12.

[1842] *2019 Amendments to Policy Statement on Customer Assistance Program 52 Pa. Code § 69.261-69.267*, Docket No. M-2019-3012599, Final Policy Statement and Order (Opinion and Order entered November 5, 2019) ("*Final CAP Policy Statement*").

[1843] OCA Statement No. 5, pp. 56-58; CAUSE-PA Statement No. 1, pp. 48-49.

[1844] *Columbia* at 258-60.

[1845] *Columbia* at 258.

[1846] *Id.* at 259 (citing *Final CAP Policy Statement Order*, p. 97).

[1847] *Id.* at 259-260 (citing *Final CAP Policy Statement Order* at n. 150).

satisfied their burden of proving that USP costs should be distributed among all the classes."[1848] The Commission concluded that OCA and CAUSE-PA failed to satisfy this burden, recognizing that parties who opposed changing the status quo of cost allocation for USP presented enough evidence to show that adopting this proposal would flout the principles of cost-causation.[1849] Further, the Commission recognized the "economic impacts commercial and industrial customers are experiencing due to the COVID-19 pandemic" as one of the factors weighing in favor of maintaining the status quo for allocation of USP costs.[1850] PAIEUG MB at 33-34.

In the instant proceeding, OCA and CAUSE-PA set forth substantially similar arguments to those presented in *Columbia*. Moreover, PAIEUG, along with OSBA, has presented similar evidence in this proceeding confirming that cost-causation principles require only residential customers to continue to fund USP.[1851] Further, Large C&I customers in PECO's service territory continue to face harsh economic impacts in light of the continuing COVID-19 pandemic.[1852] Accordingly, the Commission's findings in *Columbia* would be equally applicable in this proceeding, which would result in the PUC maintaining the status quo for collection of PECO's USP costs. PAIEUG MB at 34.

In addition, and as previously mentioned, PECO did not propose to change the status quo with respect to USP cost allocation in this proceeding.[1853] Instead, PECO contends that the instant proceeding is not the correct place to consider cost allocation proposals for USP because "PECO's gas-only [Customer Assistance Program] population is an exceedingly small part of its total [Customer Assistance Program] population."[1854] Accordingly, PECO does not support changing the USP allocation as part of this proceeding,[1855] as this matter would be more appropriately addressed in PECO's next electric base rate proceeding. PAIEUG MB at 34.

1848 *Id.* at 260.
1849 *Id.*
1850 *Id.* at 261.
1851 OSBA Statement No. 1-R, p. 23.
1852 PAIEUG Statement No. 1-R, p. 12.
1853 PECO Statement No. 10-R, p. 12.
1854 *Id.*
1855 *Id.*

Finally, assuming, *arguendo*, that the Commission modifies the collection of USP costs on PECO's natural gas system, the Commission must also determine the appropriate methodology for collection of these costs. In this instance, the PUC should adopt PAIEUG's proposal for cost allocation, as it provides the most just and reasonable basis for such allocation. Importantly, although CAUSE-PA and OCA propose a change in cost allocation, CAUSE-PA proposes no accompanying methodology for the collection of these costs from all customers.[1856] While OCA propose a methodology, its proposal is very general and lacks any meaningful detail by which the PUC can determine its appropriateness. Specifically, OCA proposes that costs be allocated on a "competitively neutral basis" and that the allocation should be based on "the percentage of revenue provided by each customer class at base rates."[1857] Based on the limited information provided, OCA's proposal appears to be unreasonable in that it ignores the basic rate making principle of cost-causation by tying customer class revenue to the funding of a program for which not all customers benefit. Conversely, PAIEUG proposes that the Commission require that the Commission allocate costs based on the number of customers. Specifically, PECO's total USP costs of $5.9 million should be divided by the total number of PECO customers.[1858] Using this methodology, no customer would pay more than $10.85 per year, which would ensure no undue hardship on customers.[1859] PAIEUG MB at 34-35.

Accordingly, because the proposal to allocate USP costs to all customer classes violates the principles of cost-causation, provides no direct benefit to customers outside of the residential class, and would place an undue burden on customers already suffering from the ongoing effects of the COVID-19 pandemic, the Commission should uphold the status quo of cost allocation for USP on PECO's system, similar to the conclusion reached by the PUC in *Columbia*. If, assuming *arguendo*, the Commission decides further consideration must be given to the allocation of USP costs on PECO's system, the more appropriate proceeding in which to undertake such review would be in PECO's next electric base rate case. Assuming *arguendo*, however, that the Commission chooses to modify the allocation of USP costs in this proceeding, the Commission should adopt PAIEUG's proposed method of cost allocation, as this

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1856 CAUSE-PA Statement No. 1, pp. 48-54.
1857 OCA Statement No. 5, p. 90.
1858 PAIEUG Statement No. 1-R, p. 13.
1859 *Id*.

methodology would ensure no undue hardship is placed on those customers who are not able to receive any low-income assistance from PECO. PAIEUG MB at 35-36.

d. Tariff Structure

i. Residential Customer Charge

PAIEUG did not brief this Specific Issue.

ii. Non-Residential Customer Rate Design.

1. Rate GC Customer Charge

PAIEUG did not offer any position on this issue.

2. Rate GC Declining Block Volumetric Charge Differential

PAIEUG did not offer a position on this issue.

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

PAIEUG recommends that the Commission reject OSBA's proposed changes to the volumetric differentials in the rate designs for Rates TS-F and TS-I.[1860] PECO offered conflicting testimony on whether or not it supports OSBA's proposal.[1861] Specifically, in the testimony that seemingly supports OSBA's proposal, PECO provided no analysis of OSBA's proposed changes in testimony and failed to explain how these changes would impact the rates for Rate TS-F and TS-I customers.[1862] OSBA likewise did not analyze any cost-of-service information related to the smaller and larger customers within these classes before suggesting

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[1860] OSBA Statement No. 1, pp. 53-56.
[1861] PECO Statement No. 7-R, p. 15; *see also* PECO Statement No. 6-R, pp. 23-24.
[1862] PECO Statement No. 7-R, p. 15.

changes to the rate designs.[1863] Given the lack of data available to support these changes and the conflicting positions taken by PECO, the Commission should reject OSBA's proposed rate design changes for Rates TS-F and TS-I in this proceeding. PAIEUG MB at 36-37.

Currently, Rates TS-F and TS-I include different volumetric charges for customers using above and below 18 mmcf per year.[1864] OSBA is proposing to shrink the differential between the charges for both classes and completed its own load factor analysis to support the TS-F change.[1865] However, OSBA explains that the Company did not provide cost-of-service information to allow OSBA to evaluate the reasonableness of the current volumetric differentials in Rates TS-F or TS-I.[1866] Although OSBA offers its own theories about shrinking these differentials, these theories were not based on a review of any specific cost-of-service information from PECO, which gives them less credibility. PAIEUG MB at 37.

PECO offered conflicting testimony in response to OSBA's proposal. PECO's Witness Bisti accepts OSBA's proposal but offers no analysis to support its reasonableness.[1867] By contrast, PECO's Witness Ding disagrees with OSBA and explains that different service characteristics for smaller and larger Rate TS-F and TS-I customers justify the current rate differentials.[1868] Given this conflicting testimony from PECO, it is entirely unclear whether OSBA's proposal is reasonable. PAIEUG MB at 37.

Moreover, when PAIEUG attempted to conduct an analysis of OSBA's proposed rate design changes, PECO did not provide data to PAIEUG in a working format, which hindered PAIEUG's ability to conduct this analysis.[1869] Based on the information PAIEUG had access to, PAIEUG determined that the proposed changes to Rate TS-F would result in a 56.2% increase in rates for large TS-F customers.[1870] Such a change would create rate shock for large TS-F customers when they are already paying above the system average ROR and PECO is

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1863 OSBA Statement No. 1, p. 53.
1864 *Id.* at 53-56.
1865 *Id.*
1866 *Id.* at 53.
1867 PECO Statement No. 7-R, p. 15.
1868 PECO Statement No. 6-R, pp. 23-24.
1869 PAIEUG Statement No. 1-S, p. 7.
1870 *Id.*; *see also* PAIEUG Exhibit BSL-2S.

proposing an even higher revenue increase for the class in its proposed revenue allocation.[1871] As large consumers of natural gas, PECO's rate has a significant impact on Rate TS-F customers' total operational budgets.[1872] In recognition of the additional economic hardships imposed by the pandemic, the Commission should not approve any rate design changes that would increase customer rates by such a significant percentage.[1873] PAIEUG MB at 37-38.

Because the current volumetric differentials for Rates TS-F and TS-I are included in PECO's tariff, which was approved by the Commission, they are deemed *prima facie* reasonable.[1874] In this proceeding, OSBA has the heavy burden of demonstrating that facts and circumstances have changed so drastically that the current differentials for Rates TS-F and TS-I within the tariff are unreasonable and must be replaced with OSBA's proposed differentials.[1875] Given the lack of supporting data for the proposed rate design changes and the conflicting testimony from PECO, OSBA fails to meet its burden of proof in this proceeding and no change to the volumetric differentials for Rates TS-F or TS-I should occur. The current volumetric differentials were previously approved by the Commission and remain reasonable. If the PUC believes that further review of this issue is warranted, in the alternative, the Commission can direct PECO to address this issue in its next natural gas base rate proceeding, along with requiring PECO to provide the analysis and information needed for the parties to determine whether such a change is warranted. PAIEUG MB at 38-39.

4. Elimination of Rate IS Margin Sharing

PAIEUG did not offer a position on this issue.

[1871] PAIEUG Statement No. 1-S, p. 7.
[1872] PAIEUG Statement No. 1-R, p. 4.
[1873] *Id.* at 12.
[1874] 66 Pa.C.S. § 316 ("Whenever the Commission shall make any rule, regulation, finding, determination or order, the same shall be prima facie evidence of the facts found and shall remain conclusive upon all parties affected thereby."); *see also Shenango Township Board of Supervisors v. Pa. Pub. Util. Comm'n*, 686 A.2d 910, 914 (Pa. Commw. Ct. 1996).
[1875] *Shenango Township Board of Supervisors v. Pa. Pub. Util. Comm'n*, 686 A.2d 910, 914 (Pa. Commw. Ct. 1996).

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

PAIEUG did not offer a position on this issue.

iii. Distribution System Improvement Charge (DSIC) Cost Allocation

PAIEUG did not offer a position on this issue.

iv. Negotiated Gas Service

PECO notes that the Company's current Commission-approved tariff permits PECO to offer negotiated (*i.e.*, discounted) gas service to customers under specified circumstances.[1876] As part of this proceeding, I&E, OCA, and OSBA contend that PECO did not establish that certain negotiated rate customers are still eligible to receive such service.[1877] To that end, OSBA recommends that, if certain customers are deemed not eligible for discounted rates, PECO's shareholders should bear the difference between tariffed rates and discounted rates for these customers; however, PECO claims that such a recommendation would violate shareholders' right to a fair return.[1878] PAIEUG RB at 28.

In response, PAIEUG would note that the customers at issue have entered into good faith, negotiated rate contracts with PECO and have budgeted for the term of such negotiated rate contracts accordingly. As such, if the PUC determines that such discounted rate is not appropriate, these customers should not be required to bear the difference between the negotiated rate and the tariff rate, as to do such would be unjust, unreasonable, and inappropriately discriminatory to such customers. Rather, PAIEUG supports OSBA's position that PECO shareholders should be responsible for such costs. PAIEUG RB at 28-29.

1876 PECO Main Brief, p. 125.
1877 *Id*.
1878 *Id*. at 127-128.

v. Theft/Fraud Investigation

PAIEUG did not brief this issue.

e. Summary and Alternatives

PAIEUG submits that PECO's use of the A&E methodology for CCOSS provides the most appropriate basis for determining class revenues and costs, as the A&E methodology most closely resembles PECO's system. Conversely, the OCA's proposed CCOSS and OSBA's proposed changes to PECO's A&E CCOSS must be rejected, as they would be in direct contradiction with the way in which PECO designs its system and incurs distribution main costs. PAIEUG MB at 39.

Conversely, PECO's resulting revenue allocation must be rejected. While PECO proposes to move all of the other classes move closer to their cost to serve, Rate TS-F, which is already above its cost to service, would be moved farther away from cost under PECO's proposal. Rather, PAIEUG's proposed rate allocation appropriately moves all customer classes, including TS-F, closer to their cost to serve while also recognizing the parameters implemented in PECO's previous base rate proceedings. To that end, if PECO is granted less than its requested rate increase, a proportionate scale back based upon PAIEUG's rate allocation would be the most just and reasonable basis upon which to allocate any rate increase among the classes. PAIEUG MB at 39-40.

In addition, Rates TS-F and TS-I currently include different volumetric charges for customers using above and below 18 mmcf of natural gas per year. As part of this proceeding, OSBA seeks to modify this differential between the classes, however, neither OSBA nor PECO provide the appropriate analysis to support this change. Moreover, because this change could result in larger customers facing significant rate shock (*i.e.*, upwards of 50%), the PUC should not allow for such a change until at least PECO's next base rate proceeding, at which time all parties should be provided ample opportunity to review the information needed to determine whether such a change is just and reasonable. PAIEUG MB at 40.

Finally, although PECO does not propose any changes in its current allocation of USP costs, both OCA and CAUSE-PA seek to allocate these costs to all customers. Because such allocation would run afoul of cost causation principles, not provide any direct benefit for non-residential customers, compound the economic hardships currently facing Large C&I customers, and ignore recent PUC precedent, the OCA's and CAUSE-PA's proposal must be rejected. Rather, the PUC should allow for the status quo to continue with respect to the allocation of these program costs. PAIEUG MB at 40.

7. ALJ's Recommendations on Rate Structure

a. Cost of Service

I recommend that the Commission use the Average and Excess (A&E) COSS, as offered by the Company, in this base rate proceeding. I agree with the Company that this methodology is reasonable because it aligns with industry standards, Commission precedent, and cost causation.

As PAIEUG indicates in support of the Company's COSS, an A&E methodology using a system load factor weighing is the most consistent with cost causation for PECO. Pursuant to *Lloyd* and related Commission precedent, a COSS must have its foundation in cost of service and allocate costs to classes based on the manner in which they are incurred.[1879] Peak demand drives PECO's distribution system planning, and therefore, PECO incurs distribution main costs based on each class's peak demand.[1880] The average demand component of the A&E calculation represents the class's average throughput.[1881] The excess demand component equals the design peak demand minus the average demand.[1882] Using a system load factor weighting properly signals that the excess demand component of the calculation should be more heavily

[1879] *Lloyd v. Pa. Publ. Util. Comm'n*, 904 A.2d 1010, 1020 (Pa. Commw. Ct. 2006) ("*Lloyd*"); *Pa. Pub. Util. Comm'n v. PPL Elec. Utils. Corp.*, Docket No. R-2010-2161694 (Opinion and Order dated October 15, 2010), p. 63; *see also Pa. Pub. Util. Comm'n v. Metro. Edison Co. and Pa. Elec. Co*., Docket Nos. R-00061366 and R-00061367 (Opinion and Order dated Jan. 11, 2007), p. 231.

[1880] PECO Statement No. 6-R, p. 7; PAIEUG Statement No. 1-R, p. 4.

[1881] PECO Statement No. 6, *Direct Testimony of Jiang Ding*, ("PECO Statement No. 6"), p. 13.

[1882] *Id.*; *see also* PECO Exhibit JD-6R, p. 5.

weighted because a class's peak demand is more important than its average demand when PECO is designing its distribution system.[1883]

While I recognize that the Commission recently noted in *Columbia Gas* that the Commission has consistently used the Peak and Average methodology (supported by the OCA in this proceeding) for NGDCs, the Commission did not rule out its use in future base rate proceedings:

> Based on our review of the Orders proffered by the Parties, regarding the OSBA's position, we find that the Average & Excess is of no significance here in that none of the Parties have submitted this type of methodology for our consideration.[1884]

Considering that the Commission has approved the use of the A&E methodology in the past as well as the language above, I cannot conclude that the A&E methodology is unacceptable.

Accordingly, since PECO's proposed A&E methodology most closely aligns with cost causation principles, I recommend that the Commission adopt PECO's COSS.

b. Revenue Allocation

In determining proposed revenue allocations in this proceeding, the parties had to consider the terms of the Settlement from the 2008 PECO Gas base rate proceeding:

> PECO agrees that, over the course of its next two gas base rate filings, it will propose to move the Rate GC and L class rates of return to the system average rate of return by moving fifty percent (50%) towards that goal in the next such filing and removing all remaining difference through the following filing. All parties retain their rights, in such future rate proceedings, to challenge that proposal through the use of class rates of return obtained through alternative cost of service studies or other ratemaking principles.[1885]

1883 PECO Statement No. 6-R, p. 7; PAIEUG Statement No. 1-R, pp. 3-5.

1884 *Columbia Gas* at 214.

1885 *Pa. Pub. Util. Comm'n v. PECO Energy Co.*, Docket No. R-2008-2028934.

PECO's current gas base rate case is the second base rate case. Due to this settlement term, the Company's proposed revenue allocation includes a 389% increase for the L rate class, and a 27% increase for the GR and TS-F classes while proposing rate decreases for the remaining classes. I agree with I&E that the 389% rate increase for the L Class is excessive and violates the concept of gradualism and could result in rate shock for L Class customers. I also agree with I&E and the OCA regarding the fairness of certain rate classes receiving rate increases, some excessively so, while other rate classes are receiving ate decreases. As such, I cannot recommend adoption of the Company's revenue allocation.

I agree with I&E that if the Commission determines to approve less than the full requested increase, then all usage rates should be scaled back proportionately based on the cost of service study ultimately approved by the Commission. Accordingly, I recommend that the Commission order a proportional scale back of rates if less than the full increase is granted. I further recommend that, if the Commission determines that a rate increase is justified, that the Commission use I&E's proposed revenue distribution, as set forth in I&E Exhibit No. 3-SR, Schedule 3, as well as the table below:

Increase and Relative Rate of Return by Rate Class					
Class	Company Revised Increase ($000)	Percent Increase/(Decrease)	I&E Revised Increase ($000)	Percent Increase/(Decrease)	I&E Revised
GR	$63,921	27.3%	$62,074	26.5%	0.97
GC	($3,877)	(3.9%)	$0	0.0%	1.04
L	$292	389.4%	$32	43.0%	-0.45
MV-F	($85)	(18.2%)	($34)	(7.2%)	1.54
MV-I	($1)	(27.4%)	$0	11.1%	2.51
IS	($4)	(11.4%)	($2)	0.0%	1.11
TCS	($497)	(72.9%)	$7	1.0%	7.09
TS-I	($75)	(0.8%)	$1,515	16.4%	1.26
TS-F	$4,583	27.7%	$664	4.0%	0.99
Total:	$64,257	17.2%	$64,257	17.2%	

c. Allocation of Universal Service Program Costs

Universal service costs are currently allocated to the residential customer class. PECO did not propose any change to the allocation of such costs in this proceeding. The OCA and CAUSE-PA each proposed that PECO allocate universal service costs to all customer classes, while OSBA and PAIEUG each opposed those recommendations.

In the Commission's *Final Policy Statement and Order* at Docket No. M-2019-3012599, the Commission noted the following regarding the recovery of universal service costs:

> We note there is no statutory or appellate prohibition that limits the recovery of CAP costs, whether specifically calculated or as part of total universal service costs, to funding from the residential class. Universal service funding from non-residential classes, while not mandatory, is permissible.[1886]

Accordingly, the Commission amended the CAP Policy Statement to address the recovery of CAP costs and determined it appropriate to consider the recovery of CAP costs from all ratepayer classes.[1887]

The OCA and CAUSE-PA supplied a plethora of arguments in favor of allocating USP costs to all customer classes. The OCA noted that there is a substantial burden placed on low-income and near poor, low wage residential customers, and that allocating USP costs to all customer classes would help to improve affordability for these customers. The OCA also noted the broad economic benefit of allocating USP costs to all customer classes, including improving employee productivity. CAUSE-PA supports allocating USP costs over all classes because nonresidential customers contribute to the cost of, and need for, the programs and also derive benefits from the programs.

PAIEUG counter-argued that allocating costs to all customer classes would violate cost-causation principles, compound the economic hardships commercial and industrial

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[1886] *Final CAP Policy Statement Order* at 96.
[1887] *Columbia Gas* at 259.

customers are experiencing due to the COVID-19 pandemic, and ignore recent PUC precedent. OSBA argued that the situation in the present case is similar to that of *Columbia Gas* in that the COVID-19 Pandemic is ongoing, and the timing, duration and effectiveness of the recovery remain in doubt.

The COVID-19 Pandemic has had harsh economic impacts on commercial and industrial as well as small business customers. When these economic conditions will improve is in doubt. Since these customers do not derive any direct benefit from the USP programs, I don't believe it is appropriate to change the manner in which PECO's USP costs are allocated. Accordingly, I recommend that the Commission deny the request to allocate PECO's USP costs to all customer classes.

d. Tariff Structure

i. Residential Customer Charge

PECO proposed to increase the Residential Customer Charge from $11.75 per month to $16.00 per month. PECO indicated that the increase was proposed to reduce the disparity between the Company's current residential customer charge and the residential customer classified costs identified in the COSS ($30.26) that should be recovered through the customer charge. PECO asserts that its current residential customer charge is the lowest among all of Pennsylvania's major gas distribution companies, and that it will still fall within the range of the residential customer charges of the other major gas distribution companies in Pennsylvania at the proposed increase price.

Both the OCA and CAUSE-PA opposed increasing the customer charge. The OCA argued that the 36% increase violates the principles of gradualism, is contrary to the promotion of energy conservation, and will have a disproportionate impact on low-income customers. The OCA asserted that any increase to the customer charge should be limited to $13. CAUSE-PA argued that PECO's proposed increase to the customer charge undermines the goals of the LIURP program to help low-income customers to reduce their bills through conservation measures.

For its part, I&E indicated that the Company's proposed customer charge is supported by the customer cost analysis. However, I&E also acknowledged that the 36% increase is a significant increase that cannot be ignored. I&E disagreed with the Company that the customer charge of other natural gas distribution companies should be the determining factor for the rates of PECO customers. I&E proposed that the customer charge be included in the scale back of rates if the Commission grants less than the full requested increase.

I agree that a 36% increase to the customer charge violates the principle of gradualism. This monthly charge cannot be avoided or reduced. No matter what PECO customers do to try to bring their residential gas bills down, they must pay this customer charge or risk losing their gas service. However, upon review of the record, I agree with I&E that the Company's proposed customer charge is supported by the customer cost analysis, and recommend that PECO's residential customer charge be included in the scale back of rates if the Commission ultimately grants PECO less than the full requested increase.

ii. Non-Residential Customer Charge

1. Rate GC Customer Charge

PECO's current Rate GC customer charge is $28.55. PECO initially proposed an increase to this charge but ultimately revised its position and now proposes to maintain the Rate GC customer charge at its current rate. The Company's proposal to leave the Rate GC customer charge unchanged is unopposed. As the proposal is unopposed, I recommend that the Commission adopt the Company's proposal to keep the Rate GC customer charge at $28.55.

2. Rate GC Declining Block Volumetric Charge Differential

PECO's Rate GC tariff currently includes a two-tier declining block volumetric tariff charge. OSBA witness Knecht explained that this tariff structure provides for lower average rates for larger customers relative to smaller customers. Mr. Knecht analyzed the primary factors that may justify a rate differential between smaller and larger customers within the Rate GC class and determined that the existing rate differential was not supported by the analysis. As a result of this analysis, Mr. Knecht recommended that the Company narrow the tariff charge differential. The Company subsequently accepted Mr. Knecht's proposal. The OSBA now supports PECO's proposed declining block rates for rate GC, and no other party opposed this modification. As the proposal is unopposed, I recommend that the Commission adopt PECO's proposed Rate GC declining block volumetric differential.

3. Rate TSF and TS-I Volumetric Charge Differential

PECO adopted a proposal advanced by the OSBA for PECO to reduce its Rate TS-F and Rate TS-I volumetric differentials. The OSBA recommends approval of the rate differentials between small and large customers in Rates TS-F and TS-I.

PAIEUG objects to this proposal for several reasons. PAIEUG maintains that the data provided by PECO to determine if the Company's load factor analysis is correct, in response to a PAIEUG discovery request, was not provided in a workable format. PAIEUG further maintains that the Company's recommended volumetric rate would disproportionately impact large Rate TS-F customers, resulting in large Rate TS-F customers receiving a 56.2% increase in volumetric rates, which is contrary to the principle of gradualism.

PECO responded that no other party challenged the format of the materials it provided for review. As to PAIEUG's allegations of rate shock, PECO responded as follows:

> [T]he Company does not believe that its proposal will result in "rate shock" to the large Rate TS-F customers. As acknowledged by Ms. LaConte, the large Rate TS-F customers are large

> commercial and industrial users that have enjoyed the benefit of no rate increase since new rates went into effect after the Company's 2010 base rate case. Mr. Knecht's recommended approach to minimizing the differential between small and large Rate TS-F customers reflects a reasonable balance in rate design that takes into account the needs of all customers. The Commission should reject Ms. LaConte's proposal and approve the Company's proposed rate design.[1888]

While PAIEUG's argument that the Company failed to provide requested data in a workable format is not persuasive, particularly since no other party had any issue with the date and because PAIEUG was able to at least determine there was a 56.2% increase in volumetric rates, PAIEUG's determination that there was a 56.2% increase in volumetric rates is persuasive. I agree with PAIEUG that this constitutes rate shock, contrary to the principles of gradualism. The argument that this increase is justified because 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 is not persuasive. I am not aware of an exception that allows for such a drastic increase simply because a customer hasn't experienced a rate increase in a number of years.

Accordingly, I agree with PAIEUG and recommend that the proposal to reduce PECO's Rate TS-F and Rate TS-I volumetric differentials be denied.

4. Rate L and Standby Sales Service

OSBA witness Knecht 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. PECO witness Schlesinger testified that total Rate L revenues under existing rates are approximately $75,000, only a portion of those revenues relate to Standby Sales Service, and that reshaping the long-standing, customer-accepted relationship between Rate L and Rate TS-F to incremental changes is not warranted. Regarding the costs associated with Mr. Knecht's proposal, Mr. Schlesinger further testified:

1888 PECO Main Brief at 121.

> In addition, Mr. Knecht's proposal simply ignores implementation and administration costs that would have to be incurred for such a fundamental change to occur. Refashioning standby sales service the way Mr. Knecht proposes would require the Company to make significant information technology ("IT") changes to its customer information and billing systems to track and bill the new form of service he proposes. A reasonable estimate of the cost of those changes exceeds by many multiples (an order of magnitude or more) the revenues that would be reassigned to different classes by adopting Mr. Knecht's proposal.[[1889]]

As pointed out by the Company, Mr. Knecht believes the end result of his proposal is consistent with the Company's proposal:

> I retain my belief that the direct approach that I propose is superior to the Company's strategy. Nevertheless, if the Commission decides that the long-standing policy of using a high-load factor distribution rate to deliver low-load-factor standby supplies remains reasonable, I conclude that the end result under the Company's proposal will be little different from my own.[[1890]]

In light of the costs to achieve Mr. Knecht's recommendation, as well as Mr. Knecht's conclusion that the end result of his proposal is consistent with the Company's proposal, I agree with PECO and recommend that the OSBA's proposal to eliminate 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 be denied.

5. Elimination of Rate IS Margin Sharing

As previously noted, PECO's Rate IS is an interruptible service that is keyed to a customer's cost of alternative fuel. Customers that take service under Rate IS are charged a customer charge plus a rate per Mcf that is (1) no less than PECO's commodity cost of gas for the month plus three cents; and (2) no more than the price, on an equivalent BTU basis, of the alternative fuel the customer is capable of consuming. PECO subtracts, from that price, its weighted average cost of flowing gas. The remainder, which is PECO's gross margin, is divided

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[1889] PECO St. 8-R, pp. 5-6.
[1890] OSBA St. 1-S at 25.

between PGC customers and shareholders: 75% is credited to purchased gas costs and returned to PGC customers and 25% is retained by the Company.[1891]

OSBA witness Knecht and OCA witness Watkins both recommended that the Company eliminate this margin sharing mechanism, with both asserting that the sharing mechanism is no longer appropriate in the context of a competitive natural gas supply market.[1892] Mr. Knecht further testified that the sharing mechanism results in an improper subsidization of utility gas supply service customers by PECO transportation-only customers and contended that the structure has not been successful in attracting new customers given that there are only two Rate IS customers.

As a result, PECO proposed eliminating the Rate IS sharing mechanism on or before December 1, 2021 as part of its next annual PGC reconciliation filing, and updated its revenue requirement, COSS, revenue allocation and proof of revenues to reflect this change. The OCA noted its support of this proposal while OSBA did not respond.

As PECO's proposal satisfies the concerns raised by the OCA and the OSBA, and since no party opposed PECO's proposal, I recommend that the Commission adopt PECO's proposal to eliminate the Rate IS sharing mechanism on or before December 1, 2021 as part of its next annual PGC reconciliation filing.

6. 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. He primarily asserted that none of these interruptible rates provide any "obvious benefit" to firm base rate customers.[1893] OSBA St. 1, pp. 43-46.

1891 PECO St. 7, pp. 9-10.
1892 *See* OSBA St. 1, pp. 43-44; OCA St. 4, pp. 28-29.
1893 OSBA St. 1, pp. 43-46.

PECO opposes the elimination of Rates IS, MV-I and TCS, arguing that 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.

As noted by the Company, 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.[1894] Accordingly, I agree with the Company and recommend that the Company maintain Rates IS, MV-I and TCS.

iii. Distribution System Improvement Charge Cost Allocation

OSBA witness Knecht contended that PECO should allocate DSIC costs among rate classes based on overall revenues. Mr. Knecht expressed concerns that PECO allocated costs related to its DSIC in such a way that the charges to Rate GC customers appeared to exceed the statutory cap of 5 percent, both historically and prospectively.[1895] Following clarifying rebuttal testimony from PECO witness Bisti, Mr. Knecht ultimately concluded that his concern that the actual DSIC exceeded the five percent limit for individual rate classes does not appear to be correct. Accordingly, the OSBA acknowledged that its concerns over the DSIC allocation issue were resolved.

iv. Negotiated Gas Service

PECO's current Commission-approved tariff permits the Company to offer negotiated (or 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

1894 PECO St. 7-R, pp. 16-19.
1895 OSBA Statement No. 1, at 46-48.

new customer, establish that the facilities to be served are likely to consume at least 18,000 Mcf of annual natural gas usage; (2) document a viable, currently available competitive alternative to service under Rates GC, L, TS-F, or TS-I; and (3) execute an NGS agreement that comports will all provisions set forth in Rate NGS.[1896] Presently, six of the Company's customers take service under Rate NGS. I&E, OCA and OSBA raised varying arguments alleging that PECO did not establish that all of these customers are still eligible to receive service under rate NGS.

I&E recommended that the Company provide an update to the competitive alternative analysis for any customer that has not had their alternative fuel source verified for a period of 5 years or more at the point at which PECO files a base rate case.[1897] I&E also recommended that the Company cease NGS service to any customer that does not have a verified alternative supply and switch those customers to the appropriate tariffed rate.[1898] Further, I&E recommended that, in future base rate cases, PECO separate the costs and revenues of customers discounted or reduced rates in their own class in the cost of service study.[1899] I agree with this request for the reasons stated by I&E. Moreover, I&E's approach is consistent with Commission precedent:

> Rather, we agree with the ALJ and I&E that it is important to periodically analyze competitive alternatives to ensure that the rates of the flex-rate customers are not discounted lower than is necessary to avoid the customer choosing the alternative supply. As I&E witness Mr. Cline indicated, this analysis is needed to provide an accurate and up-to-date analysis of competitive alternatives to show the flex rate is necessary and reasonable and to ensure that flex-rate customers make the maximum contribution to fixed costs. I&E St. 3-SR at 5. We especially agree with the ALJ and I&E that providing excessive discounts to customers is not in the public interest and would be harmful to both the Company and its customers, since the other customers would be required to make up the lost revenues when flex-rate customers pay less than tariff rates.[1900]

[1896] *See* PECO Ex. JAB-2, pp. 76-77.
[1897] I&E St. No. 3, p. 36.
[1898] *Id.*
[1899] *Id.*
[1900] *Columbia Gas* at 240.

Accordingly, I recommend that the Commission adopt I&E's recommendation that PECO provide an update to the competitive alternative analysis for any customer that has not had their alternative fuel source verified for a period of 5 years or more at the point when PECO files a base rate case.

v. Theft/Fraud Investigation

The Company's existing Tariff, Rule 17.6 establishes reconnection fees for terminations associated with non-payment, as well as fees for investigation and remediation of theft or fraud.[1901] In this proceeding, PECO has proposed to separate these two fees into distinct tariff rules, with the new Rule 17.7 specifically addressing fees for investigation and remediation of theft or fraud. Under Rule 17.7, PECO is proposing a $460 fee for investigating theft/fraud, replacing the current theft/fraud reconnection fee of $370, which PECO contends is consistent with the average cost that PECO incurs to investigate and remediate theft or fraud.[1902]

OCA witness Colton contends that the Company's proposed Rule 17.7 should be rejected because the language is vague, excessively broad, improperly applies to "applicants" and assesses a fee that improperly includes "allocated overheads and administrative costs".[1903]

PECO's proposed Tariff Rule 17.7 states as follows:

> If the Company's meters or other Company equipment on the customer's premises have been tampered or interfered with by any means whatsoever, the customer being supplied through such equipment whether an applicant or a customer as defined at pa [sic] C.S. § 1403 shall pay a theft/fraud investigation charge in addition to any amount that the Company estimates is due for service used, but not registered on the Company's meter. These theft/fraud investigation charges listed below include allocated overheads, all investigative costs and administrative cost [sic] deemed necessary by the Company to correct any and all unauthorized conditions at the premise. The Company reserves the right to assess theft/fraud investigation charges as a precedent to

1901 PECO St. No. 8-R, pp.1-2.
1902 *Id.*, p. 2.
1903 *Id.*

> reconnection of service as well as the right to assess a separate reconnection charge as described in Rule 17.6.[1904]

I agree with the OCA that the language of proposed Rule 17.7 is vague and overbroad. I'm not concerned with a "theft of service charge" applying to an "applicant" since it is conceivable that a person whose service was previously terminated for theft at one address may try to establish service at another address without paying the appropriate theft of service charges at the first address. However, the language I find concerning is "interfered with by any means whatsoever." Rule 17.7 offers no explanation of what is meant by "interfered with by any means whatsoever." That could potentially leave a customer subject to a penalty in the event of accidental or unintentional interference with the meter.

I am equally concerned with the $90 increase over the existing $370 fee. While PECO indicated that the $460 fee "is consistent with the average cost that PECO incurs to investigate and remediate theft or fraud," nothing was offered to substantiate that claim. Moreover, I agree with the OCA that it is not appropriate to include overhead and administrative costs in the charge when these charges are otherwise recovered in base rates. Accordingly, I recommend that the Commission not approve PECO's proposed Tariff Rule 17.7.

VI. CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the parties and subject matter in this proceeding. 66 Pa.C.S. § 1308(d).

2. The Commission must consider the broad public interest during a base rate proceeding and apply policy concerning the appropriate balance between prices charged to a utility's customers and returns on capital to the utility's investors. *Popowsky v. Pa. Pub. Util. Comm'n*, 542 Pa. 99, 665 A.2d 808 (1995).

1904 PECO St. 7, PECO Exh. JAB-2, PECO Energy Co. Gas Service Tariff, Pa. P.U.C. No. 4, Original Page No. 27, Tariff Rule 17.7.

3. The Commission has the authority to determine whether a requested base rate increase is unreasonable and will lead to an unjust and unreasonable rate for a utility's customers, based upon all surrounding circumstances. *Popowsky v. Pa. Pub. Util. Comm'n*, 542 Pa. 99, 665 A.2d 808 (1995).

4. Every rate made, demanded, or received by a public utility shall be just and reasonable and in conformity with the regulations and orders of the Commission. 66 Pa.C.S. § 1301.

5. The standard of proof, which a public utility must meet, in any proceeding involving a proposed or existing rate is to show that the rate involved is just and reasonable by substantial evidence. 66 Pa.C.S. § 315(a)

6. A public utility seeking a general rate increase has the burden of proof to establish the justness and reasonableness of every element of the rate increase request. A public utility's rates include every individual charge that utility demands for service offered, rendered, or furnished by the utility, whether received directly or indirectly. *Metropolitan Edison Co. v. Pa. Pub. Util. Comm'n*, 22 A.3d 353 (Pa. Cmwlth. 2011).

7. The proposed base rate revenue increase of $68.7 million, as shown in the initial filing dated September 30, 2020, and subsequently revised to $66.2 million, is not just and reasonable as required by 66 Pa.C.S. § 1301, and has not been fully supported by PECO Energy Company.

VII. ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That PECO Energy Company not be permitted to place into effect the rates contained in Tariff Gas – Pa. P.U.C. No. 4, which have been found to be unjust and unreasonable and, therefore, unlawful;

2. That PECO Energy Company be permitted to file tariffs, tariff supplements or tariff revisions containing proposed rates, rules, and regulations to increase annual revenues in the total amount of not more than $23,892,217;

3. That PECO Energy Company be required to allocate the authorized increase in operating revenues to each customer class and rate schedule within each class in the manner set forth in this Recommended Decision;

4. That PECO Energy Company be required to comply with all directives, conclusions and recommendations in this Recommended Decision that are not the subject of individual ordering paragraphs;

5. That the Complaint filed by the Office of Consumer Advocate in this proceeding at Docket Number C-2020-3022400 be dismissed and marked closed;

6. That the Complaint filed by the Office of Small Business Advocate in this proceeding at Docket Number C-2020-3022414 be dismissed and marked closed;

7. That the Complaint filed by the Philadelphia Area Industrial Energy Users Group at Docket Number C-2020-3022745 be dismissed and marked closed; and

8. That upon acceptance and approval by the Commission of the tariff supplements filed by PECO Energy Company, consistent with its Final Order, the investigation at Docket R-2020-3018929 be marked closed.

Date: April 9, 2021

/s/
Christopher P. Pell
Deputy Chief Administrative Law Judge

APPENDIX

TABLE I
PECO Energy Company - Gas Division
INCOME SUMMARY
R-2020-3018929

		Pro Forma Present Rates (a)	Company Adjustments (a)	Pro Forma Present Rates (Revised (a)	ALJ Adjustments	ALJ Pro Forma Present Rates	ALJ Revenue Increase	Total Allowable Revenues
		$	$	$	$	$	$	$
		(1)	(2)	(3) = (1 + 2)	(4)	(5) = (3 + 4)	(6)	(7) = (5 + 6)
								(b)
1.	Operating Revenue	589,779,563	234,749	590,014,312	0	590,014,312	23,892,217	613,906,529
2.	Expenses:							
3.	O & M Expense	371,100,877	(966,082)	370,134,794	(19,934,806)	350,199,988	82,963	350,282,951
4.	Depreciation	88,958,628	0	88,958,628	(804,000)	88,154,628	0	88,154,628
5.	Taxes, Other	7,545,489	0	7,545,489	(187,000)	7,358,489	73,594	7,432,083
6.	Income Taxes:							
7.	State	(14,368,706)	500,729	(13,867,978)	2,246,035	(11,621,943)	2,371,192	(9,250,751)
8.	Federal	(4,415,601)	264,641	(4,150,959)	4,249,727	98,768	4,486,538	4,585,306
9.	Total Expenses	448,820,687	(200,712)	448,619,975	(14,430,044)	434,189,931	7,014,287	441,204,218
10.	Net Inc. Available for Return	140,958,876	435,461	141,394,337	14,430,044	155,824,381	16,899,806	172,724,187
11.	Rate Base	2,461,938,790	1,616,239	2,463,555,028	(84,434,001)	2,379,121,027		2,379,121,027
12.	Rate of Return	5.73%		5.74%				7.26%

(a) Company Main Brief
(b) PECO's factor to account for incremental forfeited discounts reduced the revenue increase. Thus, calculation of net income produces a lower number than indicated on line 10.

TABLE I(A)
PECO Energy Company - Gas Division
RATE OF RETURN
R-2020-3018929

		Structure	Cost	After-Tax Weighted Cost	Effective Tax Rate Complement	Pre-Tax Weighted Cost Rate
		(1)	(2)	[(3)=(1)x(2)]	(4)	[(5)=(3)x(4)]
1.	Total Cost of Debt			1.79%		
2.	Long-term Debt	46.62%	3.84%	1.79%		1.79%
3.	Short-term Debt	0.00%	0.00%	0.00%		
4.	Preferred Stock	0.00%	0.00%	0.00%	0.711079	0.00%
5.	Common Equity	53.38%	10.24%	5.47%	0.711079	7.69%
6.		100.00%		7.26%		9.48%
7.	Pre-Tax Interest Coverage	5.30				
8.	After-Tax Interest Coverage	4.06				

TABLE I(B)
PECO Energy Company - Gas Division
REVENUE FACTOR
R-2020-3018929

1.	100%	1.00000000	
	Less:		
2.	Uncollectible Accounts Factor (*)	0.00347237	
3.	PUC, OCA, OSBA Assessment Factors (*)	0.00308026	
4.	Gross Receipts Tax	0.00000000	
5.	Other Tax Factors	-0.00128765	(a)
6.		0.99473502	
7.	State Income Tax Rate (*)	0.09990000	
8.	Effective State Income Tax Rate	0.09937403	
9.	Factor After Local and State Taxes	0.89536099	
10.	Federal Income Tax Rate (*)	0.21000000	
11.	Effective Federal Income Tax Rate	0.18802581	
12.	Revenue Factor (100% - Effective Tax Rates)	0.70733518	

(*) Company Main Brief
(a) Reflects incremental forfeited discount revenue related to base rate revenue increase.

TABLE II
PECO Energy Company - Gas Division
SUMMARY OF ADJUSTMENTS
R-2020-3018929

	Adjustments	$ Rate Base	$ Revenues	$ Expenses	$ Depreciation	$ Taxes-Other	$ State Income Tax	$ Federal Income Tax
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1.	RATE BASE:							
	CWC:							
2.	Int. & Div. (Table IV)	192,837						
3.	Taxes (Table V)	(155,055)						
4.	O & M (Table VI)	(91,783)						
5.	Plant Adjustment (BIE)	(46,821,000)						
6.	Neighborhood Gas Pilot (BIE)	(2,500,000)						
7.	Pension Asset (BIE)	(35,059,000)						
8.	REVENUES:							
9.			0				0	0
10.	EXPENSES:							
11.	Rate Case Expense (BIE)			(208,200)			20,799	39,354
12.	Payroll Expense (OCA)			(2,447,000)			244,455	462,534
13.	Employee Benefits Expense (OCA)			(315,000)			31,469	59,542
14.	Payroll Taxes (OCA)					(187,000)	18,681	35,347
15.	Outside Services (BIE)			(3,134,144)			313,101	592,419
16.	Merger Cost to Achieve Saving (BIE)			(370,000)			36,963	69,938
17.	Employee Activity Cost (OCA)			(71,000)			7,093	13,420
18.	Industry Org. Memberships (BIE)			(67,762)			6,769	12,809
19.	Regulatory Initiative Cost BIE&OCA)			18,800			(1,878)	(3,554)
20.	Energy Efficiency & Conservation (BIE)			(1,772,500)			177,073	335,040
21.	Contracting and Materials Expense (BIE)			(10,015,000)			1,000,499	1,893,045
22.	R&D (OCA)			(138,000)			13,786	26,085
23.	OPEB (BIE&OCA)			(486,000)			48,551	91,864
24.	Travel, Meals, Entertainment (OCA)			(178,000)			17,782	33,646
25.	MGP Remediation (OCA)			(287,000)			28,671	54,249
26.	Normalize Injuries and Damages Exp. (OCA)			(464,000)			46,354	87,706
27.	Depreciation (BIE)			0	(804,000)		80,320	151,973
28.	TAXES:							
29.	Interest Synchronization (Table III)						155,547	294,310
30.	TOTALS	(84,434,001)	0	(19,934,806)	(804,000)	(187,000)	2,246,035	4,249,727

	TABLE III	
	PECO Energy Company - Gas Division	
	INTEREST SYNCHRONIZATION	
	R-2020-3018929	
		Amount
		$
	(1)	(2)
1.	Company Rate Base Claim	2,463,555,028
2.	ALJ Rate Base Adjustments (Table II)	(84,434,001)
3.	ALJ Rate Base (Line 1 - Line 2)	2,379,121,027
4.	Weighted Cost of Debt (Table IA)	1.79%
5.	ALJ Interest Expense (Line 3 x Line 4)	42,540,611
6.	Company Claim [(1)]	45,545,868
7.	Total ALJ Adjustment (line 6 - Line 5)	3,005,257
8.	Company Adjustment [(1)]	1,448,233
9.	Net ALJ Interest Adjustment (Line 7 - Line 8)	1,557,024
10.	State Income Tax Rate (Table IB)	9.99%
11.	State Income Tax Adjustment (Line 9 x Line 10) (Flow to Table II)	155,547
12.	Net ALJ Adjustment for F.I.T. (Line 9 - Line 11	1,401,477
13.	Federal Income Tax Rate	21.00%
14.	Federal Income Tax Adjustment (Line 12 x Line 13) (Flow to Table II)	294,310
	(1) Company Main Brief	

TABLE IV
PECO Energy Company - Gas Division
CASH WORKING CAPITAL - Interest and Dividends
R-2020-3018929

	Accrued Interest				Preferred Stock Dividends	
		Long-Term Debt		Short-Term Debt		
	(1)	(2)		(3)	(4)	(5)
1.	Company Rate Base Claim	$2,463,555,028		$2,463,555,028	Company Rate Base Claim	$2,463,555,028
2.	ALJ Rate Base Adjustments	$ (84,434,001)		$ (84,434,001)	ALJ Rate Base Adjustments	$ (84,434,001)
3.	ALJ Rate Base	$2,379,121,027		$2,379,121,027	ALJ Rate Base	$2,379,121,027
4.	Weighted Cost of Debt	1.790%		0.00%	Weighted Cost Pref. Stock	0.00000000%
5.	ALJ Annual Interest Exp.	$42,586,266		$0	ALJ Preferred Dividends	$0
6.	Average Revenue Lag Days	43.17		43.2	Average Revenue Lag Days	43.2
7.	Average Expense Lag Days	91.25	(a)	91.3	Average Expense Lag Days	91.3
8.	Net Lag Days	-48.1		-48.1	Net Lag Days	-48.1
9.	Working Capital Adjustment					
10.	ALJ Daily Interest Exp.	$116,675		$0	ALJ Daily Dividends	$0
11.	Net Lag Days	-48.1		-48.1	Net Lag Days	-48.1
12.	ALJ Working Capital	($5,609,490)		$0		$0
13.	Company Claim (1)	($5,802,327)		$0	Company Claim (1)	$0
14.	ALJ Adjustment	$192,837		$0		$0
15.	Total Interest & Dividend Adj.	$192,837				

(1) Company Main Brief.

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

TABLE I
PECO Energy Company - Gas Division
INCOME SUMMARY
R-2020-3018929

		Pro Forma Present Rates (a)	Company Adjustments (a)	Pro Forma Present Rates (Revised (a)	ALJ Adjustments	ALJ Pro Forma Present Rates	ALJ Revenue Increase	Total Allowable Revenues
		$	$	$	$	$	$	$
		(1)	(2)	(3) = (1 + 2)	(4)	(5) = (3 + 4)	(6)	(7) = (5 + 6)
								(b)
1.	Operating Revenue	589,779,563	234,749	590,014,312	0	590,014,312	23,892,217	613,906,529
2.	Expenses:							
3.	O & M Expense	371,100,877	(966,082)	370,134,794	(19,934,806)	350,199,988	82,963	350,282,951
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5.	Taxes, Other	7,545,489	0	7,545,489	(187,000)	7,358,489	73,594	7,432,083
6.	Income Taxes:							
7.	State	(14,368,706)	500,729	(13,867,978)	2,246,035	(11,621,943)	2,371,192	(9,250,751)
8.	Federal	(4,415,601)	264,641	(4,150,959)	4,249,727	98,768	4,486,538	4,585,306
9.	Total Expenses	448,820,687	(200,712)	448,619,975	(14,430,044)	434,189,931	7,014,287	441,204,218
10.	Net Inc. Available for Return	140,958,876	435,461	141,394,337	14,430,044	155,824,381	16,899,806	172,724,187
11.	Rate Base	2,461,938,790	1,616,239	2,463,555,028	(84,434,001)	2,379,121,027		2,379,121,027
12.	Rate of Return	5.73%		5.74%				7.26%

(a) Company Main Brief
(b) PECO's factor to account for incremental forfeited discounts reduced the revenue increase. Thus, calculation of net income produces a lower number than indicated on line 10.

TABLE VI
PECO Energy Company - Gas Division
CASH WORKING CAPITAL -- O & M EXPENSE
R-2020-3018929

	Description	Company Pro forma F.T.Y. Expense	(a)	ALJ	ALJ Pro forma Expenses	Lag Days	Lag Dollars
	(1)	(2)		(3)	(4)	(5)	(6)
1.	Payroll (Dist Only)	$42,209,000		$2,447,000	$44,656,000	13.67	$610,447,520
2.	Pension Expense	$2,513,000		$0	$2,513,000	14.00	$35,182,000
3.	Commodity Purchased- Gas	$226,710,000		$0	$226,710,000	36.51	$8,277,182,100
4.	Payments to Suppliers	$63,454,000		$0	$63,454,000	56.21	$3,566,749,340
5.	Other Expenses	$96,118,000		($22,381,806)	$73,736,194	37.54	$2,768,056,723
6.							
7.							
8.		$431,004,000		($19,934,806)	$411,069,194	37.10	$15,257,617,683
9.	ALJ Average Revenue Lag	43.2					
10.	Less: ALJ Avg. Expense Lag	37.1					
11.	Net Difference	6.1		Days			
	ALJ Pro forma						
12.	O & M Expense per Day	$1,126,217					
13.	ALJ CWC for O & M	$6,838,488					
14.	Less: Company Claim (1)	$6,930,271					
15.	ALJ Adjustment	($91,783)					

(1) Company Main Brief

(a) Data on this page reflects a FPFTY.