COMMONWEALTH OF PENNSYLVANIA

April 26, 2021

E-FILED

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

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

Dear Secretary Chiavetta:

Enclosed please find the Exceptions to the Recommended Decision issued April 12, 2021, on behalf of the Office of Small Business Advocate ("OSBA"), in the above-captioned proceeding.

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

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

Sincerely,

/s/ Steven C. Gray

Steven C. Gray
Senior Supervising
Assistant Small Business Advocate
Attorney ID No. 77538

Enclosures
cc: Robert D. Knecht
Commission's Office of Special Assistants
Parties of Record

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXCEPTIONS ON BEHALF OF THE OFFICE OF SMALL BUSINESS ADVOCATE

Steven C. Gray
Senior Supervising
Assistant Small Business Advocate
Attorney ID No. 77538

For: John R. Evans
Small Business Advocate

Office of Small Business Advocate
555 Walnut Street, 1st Floor
Harrisburg, PA 17101
(717) 783-2525
(717) 783-2831 (fax)

Date: April 26, 2021

I. Introduction

The Office of Small Business Advocate ("OSBA") files these Exceptions in response to the Recommended Decision ("RD") of Deputy Chief Administrative Law Judge ("DCALJ") Christopher P. Pell that was issued on April 12. 2021.

II. Exceptions

Exception No. 1: The DCALJ's decision to recommend a 10.24% is unduly generous to utility shareholders. (RD, at 215)

The DCALJ recommended that the Public Utility Commission ("Commission") adopt the 10.24% cost of equity recommendation of the Bureau of Investigation and Enforcement ("I&E"). RD, at 215. The DCALJ concluded, as follows:

> 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.

RD, at 215. In addition, the DCALJ cited to the Commission's reasoning in *Pa. Pub. Util. Comm'n v. Columbia Gas of Pa. Inc.*, Docket No. R-2020-3018835 (Order Entered February 19, 2021) for precedent for the use of the Discounted Cash Flow methodology ("DCF"). *Id.*

The DCALJ did quote the following passage from the OSBA's Main Brief, where OSBA witness Robert D. Knecht testified:

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

> highest risk, their relative risk should imply a cost of equity capital well below 8.0 percent.

RD, at 209 (citing to OSBA Main Brief, at 5). Nevertheless, the DCALJ decided to adopt the I&E's DCF methodology. This, even though Mr. Knecht detailed the problems associated with over-reliance on the DCF methodology. *See* OSBA Statement No. 1, at 9-11.

According to the US Treasury Department, the 10-year Treasury Bond yielded 1.57 percent on April 21, 2021. Thus, at the time of this writing, the DCALJ has recommended an equity risk premium of 867 basis points.

Consequently, in light of the problems with the DCF methodology, and the excessive equity risk premium, the OSBA submits that the only reasonable ROE proposal on the record in this proceeding is an ROE of no more than the 8.75 percent recommendation of Office of Consumer Advocate ("OCA") witness Kevin W. O'Donnell, CFA.

<u>Exception No. 2:</u> The DCALJ recommendation to adopt the Company's cost of service study methodology for allocating mains costs is an error that the Commission must reverse. (RD, at 404-405)

The DCALJ has further confused the issue of what cost of service study ("COSS") methodology should be employed by a Pennsylvania natural gas distribution company ("NGDC") for allocating mains costs.

The DCALJ studiously sets forth the COSS positions of the various parties in his RD beginning on page 270 and continuing until page 404. After that lengthy summary, the DCALJ adopts, without any analysis, the reasoning of the Company and Philadelphia Area Industrial Energy Users Group ("PAIEUG"):

> 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.

RD, at 404.

The DCALJ does not address any of the defects present in the Company's A&E methodology that the OSBA identified. Furthermore, in regard to Commission precedent, the DCALJ stated, as follows:

> 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.

RD, at 405 (formatting in original).

The OSBA respectfully submits that the Commission should provide specific guidance addressing which COSS methodology to use when litigating an NGDC case. If the Peak and Average methodology is the standard, the Commission should affirmatively state that, and apply it in this case. In the alternative, if the Company's version of the A&E COSS methodology is equally acceptable, the Commission should affirmatively state that. If the Commission does so, however, it should do so recognizing that it is overturning its long-held position that the allocation of gas mains should be based in part on average demand. Both the OCA and the OSBA witnesses explained, in detail, that the Company's method is little different from a pure peak demand allocation method. OCA Statement No. 4-R, at 2-4; OSBA Statement No. 1, at 23. Moreover, if the choice of methodology is affected by the specific circumstances of the utility, the Commission should identify the specific factors that it considers when evaluating alternative mains cost allocation methods.

The Commission, the Office of ALJs, and the parties are well aware that litigation over COSS methodology is costly, time-consuming, and (as this RD illustrates) a poor use of judicial resources. The OSBA asks the Commission to clear up this issue, particularly in light of the current iteration of the Columbia Gas base rates case.

<u>Exception No. 3:</u> The DCALJ's recommendation to reject the reduction of the Rate TS-F and Rate TS-I differentials should be rejected by the Commission. (RD, at 410-411)

OSBA witness Knecht recommended that the volumetric rate differentials for service above and below 18 mmcf per year in the TS-F and TS-I tariffs be narrowed, to better align rates with the relative load factors of smaller and larger customers. OSBA Statement No. 1, at 52-56. In so doing, Mr. Knecht first proposed that the Company separate the rate classes for cost allocation purposes, because the Company applies completely separate rate charges to those groups. OSBA Statement No. 1, at 18. The Company disagreed. PECO Statement No. 6-R, at 23-24.

Mr. Knecht requested that the Company provide the data needed for OSBA to develop its own allocation study for the two sub-classes. The Company refused to provide the data. OSBA Statement No. 1, at 19.

Finally, Mr. Knecht conducted a detailed analysis of customer load factors within the TS-F and TS-I rate classes to determine the magnitude of charge difference justified by the different load patterns. OSBA Statement No. 1, at 52-56. This analysis was unrebutted. Mr. Knecht based his rate recommendations on this analysis. With minor modifications, the Company agreed with the OSBA proposal.

However, the DCALJ recommended rejection of the OSBA/Company proposal in its entirety. The DCALJ concluded, as follows:

> [B]ecause 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.

RD, at 411.

Thus, the DCALJ cites solely to "rate shock" as the reason for the decision. This use of rate shock is not consistent with normal regulatory policy. In general, rate shock concerns can and should reasonably be used to limit the progress toward cost-based rates where such rate shifts would be unreasonably large. However, in those circumstances, rate shock is used to *mitigate* the progress, not *eliminate it* entirely. The DCALJ, however, concludes that rate shock concerns justify a rate design that fails to make any progress toward intra-class balancing of revenues and costs, and simply retains the status quo relationship. While rate shock is a reasonable concern, the OSBA respectfully submits that it does not justify perpetuating intra-class inequities.

Moreover, the DCALJ failed to consider his own revenue allocation proposal when evaluating rate shock. Turning to the record evidence, the 56.2 percent value comes from the surrebuttal evidence of PAIEUG witness Billie LaConte, where she indicates that the Company's revised rate design proposal would result in a 56.2 percent increase in the base volumetric rates for the larger customers in the TS-F rate class. PAIEUG Statement No. 1-S, at 7. In support, she

attaches Exhibit ____ (BSL-2S) to her surrebuttal testimony, which is an attachment to the Company's response to PAIEUG-V-1(a). The exhibit confirms that under the Company's proposed revenue allocation for the TS-F class, and the proposed change in rate design within the TS-F class, the volumetric charge would increase by 56.2 percent.

The DCALJ's reliance on this evidence in support of rate shock is substantially problematic, for a number of reasons. First, the increase in the volumetric rates is not the overall bill impact, which includes the effect of the customer charge. Second, part of the increase in the volumetric rates is due to the roll-in of the DSIC and TCJA charges into rates, which does not represent an actual increase in rates. Third, the DCALJ uses this evidence to reject the proposed rate design for both the TS-F and TS-I rate classes, whereas the 56.2 percent value applies only to TS-F. There is no evidentiary basis for concluding that the TS-I increase supported by the quantitative evidence of OSBA and accepted by the Company constitutes rate shock. Fourth, the DCALJ rejected the Company's proposed class wide rate increase of $4.583 million (27.7%) for the TS-F class and instead recommends approval of an increase of $664,000 (4.0%), at the full $64.3 million increase. The DCALJ would then scale back the TS-F increase to reflect the reduced revenue requirement. Unfortunately, the DCALJ ignored all of these impacts when evaluating intra-class rate design for the TS-F class. Much of the 56.2 percent increase that the DCALJ found to be rate shock is in fact related to an overall class increase that the DCALJ rejects.

The OSBA hesitates to offer rate design calculations in its exceptions, but sees no alternative for addressing the DCALJ's failure to consider both revenue allocation and rate design when evaluating rate shock.

Appendix A to these exceptions shows the Rate TS-F proof of revenues. The upper table in Appendix A simply replicates the Company's response to PAIEUG-V-1(a) upon which Ms. LaConte relied. That table shows the 56.2 percent figure for the volumetric charge, as well as the effects of customer charge increases and the effects of rolling in the DSIC and TCJA. The bottom half shows the rate implications of the DCALJ's revenue allocation, an increase of $664,000 rather than $4.583 million. As shown, the increase for the volumetric charge for larger customers (including the effects of the DSIC and TCJA roll-ins) is 24.1 percent at the Company's full claimed rate increase with the DCALJ's revenue allocation. This value is lower than the *class average* increase approved by the DCALJ for the residential class. It is therefore not "rate shock."

The OSBA therefore respectfully recommends that when evaluating rate design for the TS-F class, the Commission (a) consider the combined implications of the Commission's decision on revenue allocation and the proposed change in rate design, and (b) reject the DCALJ's conclusion that rate shock is a reasonable justification to prevent any intra-class progress toward cost-based rates.

III. Conclusion

Wherefore, the OSBA respectfully requests that the Commission consider OSBA Exceptions Nos. 1, 2, and 3, as set forth above, and revise the Recommended Decision if it believes appropriate.

Respectfully Submitted,

/s/ Steven C. Gray

Steven C. Gray
Senior Supervising
Assistant Small Business Advocate
Attorney ID No. 77538

Commonwealth of Pennsylvania
Office of Small Business Advocate
Forum Place
555 Walnut Street, 1st Floor
Harrisburg, PA 17101
(717) 783-2525
(717) 783-2831 (fax)

Dated: April 26, 2021

APPENDIX A

OSBA Exceptions Appendix A
Rate TS-F Proof of Revenue

Exhibit ____ (BSL-2S): PECO Exhibit JAB-4 Revised							
	Billing	Present Rates		Proposed Rates		Increase	
	Determinant	Rate	Revenue	Rate	Revenue	Dollar	Percent
Customer Charges							
>= 18,000 mcf annually (TFL)	1,488	$199.00	296,112	$249.00	370,512	74,400	25.1%
< 18,000 mcf annually (TFG)	4,008	$166.00	665,328	$208.00	833,664	168,336	25.3%
Total Customer Charge			961,440		1,204,176	242,736	25.2%
Variable Distribution Charges							
>= 18,000 mcf annually (TFL)	2,372,500	Negotiated	877,825	Negotiated	877,825	0	0.0%
Negotiated Gas Sales	6,714,487	$0.8297	5,571,010	$1.2964	8,704,607	3,133,597	56.2%
Commodity TSF Mcf	1,859,565	$0.8297	1,542,881	$1.2964	2,410,725	867,844	56.2%
Additional Commodity (15 days TCQ)							
< 18,000 mcf annually (TFG)							
Commodity TSF Mcf	2,307,094	$1.7384	4,010,652	$2.1027	4,851,237	840,585	21.0%
Additional Commodity (15 days TCQ)	1,474,057	$1.7384	2,562,501	$2.1027	3,099,570	537,070	21.0%
Distribution System Improvement Charge (DSIC)			468,621		0	-468,621	-100.0%
Tax Reform (TCJA) - Base Rate Impact			125,063		0	-125,063	-100.0%
Credits to PGC			444,878		0	-444,878	-100.0%
Total Variable Distribution Charge			15,603,431		19,943,964	4,340,534	27.8%
Adjusted Total Distribution Revenue			16,564,871		21,148,140	4,583,270	27.7%

Adjusted to ALJ TS-F Rate Increase: $664,000							
	Billing	Present Rates		Proposed Rates		Increase	
	Determinant	Rate	Revenue	Rate	Revenue	Dollar	Percent
Customer Charges							
>= 18,000 mcf annually (TFL)	1,488	$199.00	296,112	$249.00	370,512	74,400	25.1%
< 18,000 mcf annually (TFG)	4,008	$166.00	665,328	$208.00	833,664	168,336	25.3%
Total Customer Charge			961,440		1,204,176	242,736	25.2%
Variable Distribution Charges							
>= 18,000 mcf annually (TFL)	2,372,500	Negotiated	877,825	Negotiated	877,825	0	0.0%
Negotiated Gas Sales	6,714,487	$0.8297	5,571,010	$1.0299	6,915,273	1,344,263	24.1%
Commodity TSF Mcf	1,859,565	$0.8297	1,542,881	$1.0299	1,915,172	372,291	24.1%
Additional Commodity (15 days TCQ)							
< 18,000 mcf annually (TFG)							
Commodity TSF Mcf	2,307,094	$1.7384	4,010,652	$1.6705	3,854,008	-156,644	-3.9%
Additional Commodity (15 days TCQ)	1,474,057	$1.7384	2,562,501	$1.6705	2,462,417	-100,084	-3.9%
Distribution System Improvement Charge (DSIC)			468,621		0	-468,621	-100.0%
Tax Reform (TCJA) - Base Rate Impact			125,063		0	-125,063	-100.0%
Credits to PGC			444,878		0	-444,878	-100.0%
Total Variable Distribution Charge			15,603,431		16,024,695	421,264	2.7%
Adjusted Total Distribution Revenue			16,564,871		17,228,871	664,000	4.0%

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

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

The Honorable Christopher P. Pell
Administrative Law Judge
Pennsylvania Public Utility Commission
801 Market Street, Suite 4063
Philadelphia, PA 19107
CPell@pa.gov

Scott B. Granger, Esquire
Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
400 North Street, 2nd Floor
Commonwealth Keystone Building
Harrisburg, PA 17120
sgranger@pa.gov

Kenneth M. Kulak, Esq.
Anthony C. DeCusatis, Esq.
Catherin G. Vasudevan, Esq.
Brooke E. McGlinn, Esq.
Morgan, Lewis and Bockius LLP
1701 Market Street
Philadelphia, PA 19103
ken.kulak@morganlewis.com
anthony.decusatis@morganlewis.com
catherine.vasudevan@morganlewis.com
brooke.mcglinn@morganlewis.com

Elizabeth R. Marx, Esquire
John W. Sweet, Esquire
Ria M. Pereira, Esquire
118 Locust Street
Harrisburg, PA 17101
pulp@palegalaid.net

Anthony E. Gay, Esq.
Jack R. Garfinkle, Esq.
Brandon J. Pierce, Esq.
PECO Energy Company
2301 Market Street
P.O. Box 8699
Philadelphia, PA 19101
anthony.gay@exeloncorp.com
jack.garfinkle@exeloncorp.com
brandon.pierce@exeloncorp.com

Barrett Sheridan, Esq.
Phillip Demanchick, Esq.
Christy Appleby. Esq
Darryl A. Lawrence, Esq.
Laura Antinucci, Esq.
Office of Consumer Advocate
555 Walnut Street
5th Floor Forum Place
Harrisburg, PA 17101-1923
Ocapecogas2020@paoca.org

Charis Mincavage, Esquire
Adeolu Bakare, Esquire
Jo-Anne S. Thompson, Esquire
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
cmincavage@mcneeslaw.com
abakare@mcneeslaw.com
jthompson@mcneeslaw.com

/s/ Steven C. Gray

____

Steven C. Gray
Senior Supervising
Assistant Small Business Advocate
Attorney ID No. 77538

DATE: April 26, 2021