**BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN**

Application of Wisconsin Public Service Corporation for Authority to Adjust Electric and Natural Gas Rates	Docket No. 6690-UR-127

REPLY BRIEF OF THE CITIZENS UTILITY BOARD

I. INTRODUCTION

CUB writes to correct Applicant's misunderstanding of the law, to respond briefly to Applicant's flawed technical arguments, and to point out the danger in an investor-centric approach that mistakenly prioritizes inflated IOU stock prices over just and reasonable rates for customers.[1]

II. ARGUMENT

a. The law requires that commissions protect the public interest, not maintain elevated IOU stock prices.

Applicant cites the *Hope*[2] standard that "[s]etting a reasonable ROE involves a 'balancing of the investor and consumer interests" (WPSC Revised Init. Br. at 3) but then analyze this standard solely from the perspective of the needs of the utility investor. This is a misreading of *Hope*, antithetical to the concept of "balance," and inconsistent with the public interest. (*See* CUB Init. Br. at 3-5)

It is well-established, and CUB would not dispute, that a commission may not set confiscatory rates[3] and shall set a return "sufficient to assure the confidence in the financial

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[1] The acronyms and names defined in CUB's initial brief have the same meaning in this reply brief.
[2] *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944) ("*Hope*").
[3] *See, e.g., Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W.Va*., 262 U.S. 679 (1923) ("*Bluefield*").

integrity of the enterprise, so as to maintain its credit and to attract capital,"[4] However, ROE jurisprudence, then and now, relies on balancing investor and consumer concerns, which requires a consideration of the customer's interest that is absent from the Applicant's testimony and brief. The Court has warned us that a one-sided, investor-centric approach that dismisses consumers can result in unjust and unreasonable rates that are inconsistent with the public interest.

> . . . the investor interest is not the sole interest for protection. The investor and consumer interests may so collide as to warrant the rate-making body in concluding that a return on historical cost or prudent investment though fair to investors would be *grossly unfair to the consumers*.[5] (emphasis supplied)

b. There is overwhelming evidence of the Company's, and the record's, one-sidedness.

Throughout this proceeding, the Applicant has displayed a persistent unwillingness or inability to go beyond rhetoric to discuss what is truly at issue: the Company's delivery of safe, reliable, and affordable utility services. For example, not once in its initial brief does Applicant mention what it is asking the Commission to authorize: a significant residential customer rate increase for electric and gas service of roughly 14.58% and 8.85%, respectively, (Ex.-WPSC-Eidukas-SA2, Schedule 9, Page 1&4 of 23, p. 186, 189), not inclusive of any final adjustments for fuel costs, which are anticipated to grow significantly in 2023.

Further, in the 6-page section of the Company's brief that is titled so as to indicate it will include a discussion of the customers' perspective ("I. WPSC'S REQUESTED ROE BALANCEs THE INTERESTS OF CUSTOMERS AND INVESTORS"), the Company mentions "customer," "consumer," or "ratepayer" not once. (WPSC Revised Init. Br. at 5-11). Yet "investor" appears fifteen times in this section alone. Indeed, the Applicant's entire brief is

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[4] *Id.* at 679.
[5] *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 608 (1942) (Justices Black, Douglas, and Murphy, concurring).

an argument in favor of a high ROE supported by high residential rates, in order to keep utility stock prices favorable to shareholders, with no acknowledgement of what inflated ROEs or unfavorable revenue allocation costs customers.

It appears that the Applicant gave little if any consideration to how its requested rate increase might affect customers. Among the Company's ten expert witnesses, counselled by six attorneys, none offered direct testimony about energy burden, energy insecurity, or other issues facing low- to middle-income residential customers. (Direct-WPSC-Eidukas-r-3-4) While CUB intervened on behalf of the public interest and participated in its full capacity, CUB is a highly resource-constrained nonprofit that must cautiously and strategically choose which public interest issues to raise in which cases. This means, unfortunately, that CUB must neglect some of the many customer issues that merit Commission consideration. Without other intervenors raising customer-centering issues that the Applicant should itself raise, the record in this proceeding lacks adequate expert evidence with respect to the interests of Wisconsin's customers.

c. **CUB's proposal is not unprecedented or radical; it is just a necessary return to a complete discussion of the balancing of investor and customer interests that is fundamental to public utility regulation.**

CUB's initial brief addresses the infirmities of the Applicant's financial argument in support of an elevated ROE (p. 5-12) and points to the relevant record evidence, and CUB will not repeat these here. Instead, CUB replies to pointed inaccuracies in Applicant's initial brief.

The Applicant misinterprets the Commission's final decision in 6690-UR-115 to devise what they call the "Principal Factor" approach to establishing ROEs. (WPSC Revised Init. Br. at 15-18) In formulating this new approach, the Applicant forgot the other factor that merits as much consideration: the customer. Under the "Principal Factor" approach, the Applicant would have the Commission subordinate utility customers to IOU investors, contrary to the law and well-established regulatory practices and principles. This is "half-baked" indeed. (*see* WPSC Revised Init. Br. at 20)

The Applicant contrasts its preferred "Principal Factor" approach with what it calls "Dr. Kihm's approach." (WPSC Revised Init. Br. at 14) The Applicant's 3-step summary of "Dr. Kihm's approach" does not accurately depict what CUB has advocated for in this proceeding.[6] For a better understanding of CUB's approach, refer to the 6-step summary on p. 16-17 of CUB's initial brief.

In a nutshell, CUB advocates for a just and reasonable ROE determination that begins with a technically-sound and evidence-based estimate of a utility's cost of equity (CUB Init. Br. at 5-12). This cost of equity estimate yields a "zone of reasonableness"[7] that indicates the minimum return at which a utility protects its existing investors, consistent with *Hope*,[8] and is able to attract new capital, consistent with *Bluefield*.[9] It is the zone above which the Commission's primary concern with the utility's investors ends and a consideration of justness and reasonableness with respect to the customers begins,[10] where the Commission *balances* investor and customer interests. Here "[t]he consumer interest cannot be disregarded in determining what is a 'just and reasonable' rate."[11] CUB proposes that in authorizing ROEs

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[6] CUB leaves it up to the Commission to determine the extent to which the Applicant deliberately sought to confuse the record by muddying the critical distinction between the observable cost of equity and authorized ROE. (*See, e.g.,* Rebuttal-WPSC-Bulkley-3; Party Hr'g Tr. 71:2-12, 83:11-25) Additionally, CUB puzzled over the Applicant's inscrutable criticism that "CUB failed to actually identify what the Company's ROE is" (WPSC Revised Init. Br. at 20) and can only conclude that Applicant is trying to say something different from what is written here.
[7] *See, e.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968).
[8] *Hope, supra,* at
[9] *Bluefield, supra,* 679.
[10] *Natural Gas Pipeline Co.,* supra, 606-607.
[11] *Id.* at 607.

above the "zone of reasonableness" the Commission consider the utility's performance with respect to the delivery of safe, reliable, and affordable service in determining just and reasonable rates. (CUB Init. Br. 13-17)

Far from this being "out of the mainstream" (*see* WPSC Revised Init. Br. at 15), commissions across the country make ROE adjustments every year.[12] The Applicant itself presented four examples: Connecticut Light & Power (Eversource), Minnesota Power (ALLETE), Houston Electric (Centerpoint Energy), and Arizona Public Service (APS) (Pinnacle West). (Rebuttal-WPSC-Bulkley-41-45) While the Applicant's ROE expert suggested dire financial consequences due to these ROE reductions, she in fact had no quantitative evidence that these utilities had any difficulty attracting capital when they chose to do so. (Party Hr'g Tr. 77:22-79:8)

In the APS case,[13] it was not just an ROE reduction but also a disallowance of $215.5 million for investments in suspended carrier reactors (SCRs) (Ex.-PSC-ACC Decision-p. 280) that resulted in the company rethinking its strategy. (Party Hr'g Tr. 242: 21-23). The words of Pinnacle West Chairman and CEO Jeff Guldner (Surrebuttal-CUB-Kihm-r-14) shed light on the implications of that decision:

> As we look ahead, the path for Pinnacle West and our primary subsidiary Arizona Public Service is filled with promise. While there may be challenges, these are outweighed by opportunities for growth, progress in the transition to clean energy and dedication to an improved customer experience. The rate case outcome we saw in 2021 was not what we wanted or expected – nor was it constructive. Nonetheless, the decision did not change who we are and what we do, and it did not change our promise as a company: our commitment to deliver value to our customers, our communities, and to you, our shareholders. It is your confidence and investment in us that make it possible to deliver the product and services that power Arizona's economy and way of life, something we do not take for granted.

[12] It is simply untrue that "CUB can identify no other state commission that follows anything like it." (WPSC Revised Init. Br. at 15)

[13] *In re the matter of the Application of Arizona Public Service Co,* 2021 WL 5866862 (Ariz. C.C.). (Ex.-PSC-ACC Decision)

In committing to renewed progress in the clean energy transition and to "dedication to an improved customer experience," APS has taken notice of the Arizona Corporation Commission's (ACC) diligence in balancing customer and investor interests.[14] When the Applicant quotes an equity analyst opinion that the "Arizona Corporation Commission is now confirmed to be the single most value destructive regulatory environment in the country as far as investor-owned utilities are concerned," it is indeed presenting the investor perspective. (Direct-WPSC-Bulkley-10) A commission adhering to standards for prudent investment and just and reasonable rates might be "destructive" with respect to over-inflated stock prices, but from the customer's perspective ACC's rebalancing of investor and customer interests means better service and lower rates. Requiring APS to operate more effectively and efficiently is sound utility regulation.

The Applicant provides additional examples of pragmatic ROE adjustments. Among the final decisions listed on page 17-18 of the Company's initial brief, a number authorize ROE reductions, including 6690-UR-116 (-50 basis points), 6690-UR-117 (-50 basis points), 6690-UR-120 (-60 basis points), 5-UR-102 (-60 basis points), and 5-UR-103 (-45 basis points). (Ex.-PSC-Adams-1: Schedule 9, p. 3 of 3) The nationwide regulatory trend has been a steady reduction in average authorized ROEs since 1980, including a notable downward trend from June 2012 to June 2022. (Ex.-PSC-Adams-1: Schedule 9 p. 2 of 3)[15]

In fact, when asked explicitly to consider the past few decades of utility regulation, the Company's financial witness was unable to give one example of an ROE reduction ever leading

[14] Meanwhile, APS is appealing the $215.5 million disallowance and 20 basis points of ROE reduction and (Ex.-PSC-APSC Petition)

[15] The most recent record evidence in this proceeding shows national average utility authorized ROEs as of June 30, 2022 to be 9.35% for all electric utilities, 9.50% for vertically-integrated electric utilities, and 9.22% for natural gas utilities. (Ex.-PSC-Adams-1: Schedule 9 p. 1 of 3)

to an inability of a utility to attract capital. (Party Hr'g Tr. 81:2-25) Nor did the Applicant provide evidence of an ROE adjustment ever impairing a utility's delivery of safe, reliable, and affordable utility service after significant ROE reductions. CUB has examined the outcomes of historical ROE decisions, unlike the Applicant, and has found no such example. While an IOU may *choose* not to seek funding, out of prudence or for any other legitimate business reason, utilities are always able to attract capital. Duke Energy raised billions of dollars of capital while earning ROEs of 7.0% for a decade. (Direct-CUB-Kihm-74-75) ComEd's bonds are rated "A" with an ROE of 7.36%. (*Id.* at 75) These are just a few examples. It is unclear why APS's 8.7% ROE[16] is even worthy of mention, given the evidence that utilities earning ROEs 150 basis points lower than APS's for extended periods have ready access to capital at reasonable rates.

CUB advocates for thorough and balanced decision-making in this proceeding and for an ROE authorization that is well within the Commission's duty and discretion. The Commission should resist the Applicant's attempts to dissuade them otherwise. (*See* WPSC Revised Init. Br. at 22-23) The Commission should rely on established law and sound finance principles, not unsubstantiated conjecture. The record shows that lowering the Applicant's ROE to 9.1 or 9.0% will save customers money with no impairment to the Company's ability to attract capital at reasonable rates and no impairment to the provision of safe, reliable, and affordable utility service to customers. Further, as discussed above, the evidence suggests that ROE reductions have been followed by *more* affordable and *better* utility service.

d. Two technical points merit brief attention.

With respect to cost of equity estimates, the Applicant suggests that rising interest rates forced CUB's financial expert to increase CUB's cost of equity estimate. (WPSC Revised Init.

[16] The Applicant fixates on the Arizona Corporate Commission's ROE authorization for APS as an example of "negative outcomes for utilities." (Direct-WPSC-Bulkley-9-10; Rebuttal-WPSC-Bulkley-41-45)

Br. at 20) This, again, is a mischaracterization of CUB's approach. Basic finance principles require always using the current market rate, whether that increases or decreases the cost of equity estimates, and this is the fact-based approach CUB takes. (Surrebuttal-CUB-Kihm-r-4-6) In the course of this proceeding, CUB revised its cost of equity estimates to reflect the most current market conditions, and those revised estimates were still several hundred basis points below the Applicant's recently-authorized ROE. (Surrebuttal-CUB-Kihm-r-7:1-2) The Company's financial expert witness does not follow sound financial principles in arriving at cost of equity estimates, as evidenced by the historical inaccuracy of this expert's utility stock price predictions from 2014 to 2020. (Ex.-CUB-Kihm-3) In all 11 cases, the Company's witness predicted utility stock prices would decrease, which would increase cost of equity estimates from the DCF model. In fact, one year later utility stock prices had *increased* in 9 of the 11 cases. Two years later utility stock prices had increased for 9 out of 9, or 100%, of the utilities. (Two of the forecasts were too recent for 2-year forecast assessments.) In other words, the DCF model results consistently overstated costs of equity.[17]

With respect to revenue allocation, the Applicant's mid-stream embrace of WIEG's analytically-flawed electric revenue allocation (CUB Init. Br. 17-26) now comes within the context of the proposed settlement agreement, which includes a write-off of WPSC's COVID-19 deferral balances. (SA-Direct-WPSC-Eidukas-3) These write-offs total $8.1 million for WPSC (Rebuttal-CUB-Singletary-21), which equates to a test year revenue requirement reduction of approximately $4 million. (Ex.-WPSC-Eidukas-SA2; Ex.-WPSC-Eidukas-SA1, Schedule 6, p.4 of 4) In proposing to adopt WIEG's preferred revenue allocation, the Applicant fails to acknowledge the harm this would inflict on WPSC's residential customers. WIEG's proposed

[17] *In re the matter of the Application of Arizona Public Service Co, supra,* thoroughly addresses the shortcomings of Ms. Bulkley's DCF model results.

revenue allocation would in fact divert all of the benefits of the COVID-19 deferral write-offs, which were a significant “win” in CUB’s negotiation with the Applicant, to WPSC’s large industrial customers.

e. For residential customers, utility affordability has serious consequences with respect to well-being.

Inflated ROEs are expensive for customers, and that has consequences. In this proceeding this perspective is presented in the public comments that customers filed. For example:

> It seems extremely poorly timed to raise rates on a necessity like electricity and natural gas. People are struggling to make ends meet after having grocery, housing, gas, clothing, and all other necessities' prices skyrocketing over the past very few short years. We keep our thermostat turned down so far in winter we have to wear coats in the house and still our bills are astronomical. (*Public Comment of Julie Hathaway, Sturgeon Bay, WI,* filed September 28, 2022)(PSC REF#: 448312)

> This is a terrifying time for all aspects of financial security for the year round residents, especially those that aren`t bringing in 6 figures+ household income. Please consider those individuals in determining rate increase, or the way in which one may be executed. (*Public Comment of Adrienne Shansky, Fish Creek, WI,* filed September 28, 2022)(PSC REF#: 448272)

> Can not afford another rate increase. I am a widow on a fixed income. Doing my best do decrease my wps bill, But way bother anymore. Every time I try to save on energy use YOU raise the rates ,Why??? I can not keep up, it is all the fault of big money Hungary companies. Thank you for your time. . . (*Public Comment of Marlene French, DePere, WI,* filed September 1, 2022)(PSC REF#: 446431)

Energy affordability is not, for the vast majority of customers, a question of appreciating or depreciating investments. For customers, especially low-income residential customers, it is a question of health and safety. The significant rate increase that the Applicant seeks must be viewed in this context.

III. CONCLUSION

CUB maintains the positions presented in its initial brief, including the conclusions that:

- an authorized ROE of 9.0 or 9.1 percent would be a meaningful step toward correcting the problem of excess utility returns paid for by Wisconsin customers (CUB Init. Br. at 2-8); and
- the Applicant's originally-proposed electric revenue allocation is consistent with the public interest, while WIEG's revised proposed electric revenue allocation is not.

This proceeding presents an opportunity for the Commission to give weight to the interests of residential customers, including low-income customers, in determining just and reasonable rates. CUB encourages the Commission to do so and appreciates the opportunity to participate in this proceeding.

Dated this day, October 20, 2022.

Respectfully Submitted,

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