**COMMONWEALTH OF PENNSYLVANIA**


OFFICE OF CONSUMER ADVOCATE
555 Walnut Street, 5th Floor, Forum Place
Harrisburg, Pennsylvania 17101-1923
(717) 783-5048
800-684-6560 (in PA only)

IRWIN A. POPOWSKY
Consumer Advocate

FAX (717) 783-7152
consumer@paoca.org


February 17, 2010

James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RE: Petition of Duquesne Light Company for Approval of its Smart Meter Technology Procurement and Installation Plan
Docket No. M-2009-2123948

Dear Secretary McNulty:

Enclosed for filing are the Exceptions of the Office of Consumer Advocate to the Initial Decision issued on January 28, 2010 by the Honorable Robert P. Meehan, in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully Submitted,

David T. Evrard

David T. Evrard
Assistant Consumer Advocate
PA Attorney I.D. # 33870

Enclosures
cc: Honorable Robert P. Meehan

00120962.docx

CERTIFICATE OF SERVICE

| | | |
|---|---|---|
| Petition of Duquesne Light Company for<br>Approval of its Smart Meter Technology<br>Procurement and Installation Plan | :<br>:<br>: | Docket No. M-2009-2123948 |

I hereby certify that I have this day served a true copy of the foregoing document, the Exceptions of the Office of Consumer Advocate to the Initial Decision issued on January 28, 2010 by the Honorable Robert P. Meehan, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code Section 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 17th day of February 2010.

SERVICE BY E-MAIL and INTEROFFICE MAIL

Charles Daniel Shields, Esquire
Office of Trial Staff
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

SERVICE BY E-MAIL and FIRST CLASS MAIL

Gary A. Jack
Assistant General Counsel
Duquesne Light
16th Floor
411 Seventh Avenue
Pittsburgh, PA 15219
Counsel for: *Duquesne Light Company*

Sharon E. Webb
Assistant Small Business Advocate
Office of Small Business Advocate
Commerce Building, Suite 1102
300 North Second Street
Harrisburg, PA 17101
Counsel for: *Office of Small Business Advocate*

Pamela Polacek, Esquire
Shelby A. Linton-Keddie, Esquire
Barry A. Naum, Esquire
McNees Wallace & Nurick, LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Counsel for: *Duquesne Industrial Intervenors*

Kurt E. Klapkowski, Assistant Counsel
Commonwealth of Pennsylvania
Department of Environmental Protection
RCSOB, 9th Floor
400 Market Street
Harrisburg, PA 17101-2301
Counsel for: *Department of Environmental Protection*

Theodore S. Robinson, Esquire
Citizen Power
2121 Murray Avenue
Pittsburgh, PA 15217
Counsel for: *Citizen Power, Inc.*

Harry S. Geller, Esquire
John C. Gerhard, Esquire
Julie George, Esquire
Pennsylvania Utility Law Project
118 Locust Street
Harrisburg, PA 17101-1414
Counsel for: *Pennsylvania Association of Community Organizations for Reform Now*

Christopher A. Lewis, Esquire
Christopher R. Sharp, esquire
Melanie J. Tambolas, Esquire
Blank Rome LLP
One Logan Square
Philadelphia, PA 19103
Counsel for: *Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.*

Divesh Gupta
Constellation NewEnergy
111 Market Place
Suite 500
Baltimore, MD 21202
Counsel for: *Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc*

David T. Evrard
_______________________________
David T. Evrard
Assistant Consumer Advocate
PA Attorney I.D. # 33870
E-Mail: DEvrard@paoca.org
Tanya J. McCloskey
Senior Assistant Consumer Advocate
PA Attorney I.D. # 50044
E-Mail: TMcCloskey@paoca.org

Counsel for
Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152
00116979.docx

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

| | | |
|---|---|---|
| Petition of Duquesne Light Company for Approval of its Smart Meter Technology Procurement and Installation Plan | : : : | Docket No. M-2009-2123948 |

---

EXCEPTIONS
OF THE
OFFICE OF CONSUMER ADVOCATE

---


David T. Evrard
Assistant Consumer Advocate
PA Attorney I.D. # 33870
E-Mail: DEvrard@paoca.org
Tanya J. McCloskey
Senior Assistant Consumer Advocate
PA Attorney I.D. # 50044
E-Mail: TMcCloskey@paoca.org

Counsel for:
Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152


Dated: February 17, 2010

TABLE OF CONTENTS

TABLE OF AUTHORITIES

**Cases**



**Administrative Decisions**



**Statutes**

## I. INTRODUCTION

On August 14, 2009, Duquesne Light Company (Duquesne or Company) filed with the Commission its Smart Meter Procurement and Installation Plan (Smart Meter Plan or Plan) along with supporting testimony and a Petition seeking approval of the Plan. Interested parties were given the opportunity to provide written comments on the Plan until September 25, 2009. The Office of Consumer Advocate (OCA) submitted comments on that date.

On September 2, 2009, the OCA submitted its Notice of Intervention and Public Statement. A Notice of Appearance was filed by the Commission's Office of Trial Staff (OTS) on August 20, 2009, and the Office of Small Business Advocate (OSBA) submitted its Notice of Intervention and Public Statement on September 25, 2009. Petitions to Intervene were filed by the Duquesne Industrial Intervenors (DII), the Department of Environmental Protection (DEP), Citizen Power, Inc., the Pennsylvania Association of Community Organizations for Reform Now (ACORN), and Constellation New Energy, Inc. and Constellation Commodities Group, Inc. (together, Constellation).

The matter was assigned to the Office of Administrative Law Judge and further assigned to Administrative Law Judge Robert P. Meehan. A prehearing conference was held on October 7, 2009, at which time the various petitions for intervention were granted and a procedural schedule was set. Pursuant to the requirements of the Implementation Order, a Technical Conference was held on Duquesne's Plan on October 27, 2009. Thereafter, the procedural schedule called for the submission of Direct Testimony (by parties other than the Company) on October 29, the submission of Rebuttal Testimony on November 6, and the submission of Surrebuttal Testimony on November 12. A single day of evidentiary hearings was conducted on November 17, 2009.

The OCA filed the testimony of its expert witnesses in this proceeding Ms. Christina R. Mudd[1], Mr. Thomas S. Catlin[2] and Dr. Dale E. Swan[3]. Each filed Direct and Surrebuttal testimony.

The Initial Decision (I.D.) of Judge Meehan was issued on January 28, 2010. With regard to issues relevant to the Exceptions being filed, the ALJ ruled as follows: (1) that until Duquesne has its return on equity determined by the Commission in a fully-litigated base rate case, the return on equity to be used for calculating the Smart Meter Charge (SMC) should be the equity returns published by the Bureau of Fixed Utility Services (FUS) in the Quarterly Earnings Report; (2) that the capital structure to be used in calculating Duquesne's SMC shall include a 59% equity ratio so long as its actual equity ratio is greater than 59%; and (3) that Duquesne should allocate the common costs related to smart meter deployment in proportion to the meter costs directly assigned to each meter group (single-phase and multi-phase) as proposed by the OSBA. In making the latter ruling, the ALJ rejected the OCA proposal which provided for allocating the common costs on the basis of energy and demand, which is in proportion to the benefits expected to be received by the respective meter groups.

---

1 Ms. Mudd is a Senior Analyst with Exeter Associates, Inc. Ms. Mudd holds a Bachelor of Science degree from James Madison University and a Master of Arts degree in International Affairs from Johns Hopkins University. Ms. Mudd's areas of concentration for her Master's degree were economics and energy policy. Since 1998, Ms. Mudd has worked in positions either for private consulting firms or the State of Maryland in which her work has involved the areas of distributed energy, renewable energy, energy efficiency and environmental policy. With Exeter, Ms. Mudd focuses her work on electricity regulation, energy efficiency, renewable energy, and climate change. Under a contract with the National Association of Regulatory Utility Commissioners (NARUC), Ms. Mudd has served as the Executive Director for the National Council on Electricity Policy.

2 Mr. Catlin is a principal with Exeter Associates, a consulting firm specializing in issues pertaining to public utilities. Mr. Catlin holds a Master of Science degree in Water Resources Engineering and Management from Arizona State University. He has also completed graduate courses in financial and management accounting. Mr. Catlin has over 25 years of experience in the analysis of utility operations with an emphasis on utility rate filings.

3 Dr. Dale E. Swan is a senior economist and principal with Exeter Associates, Inc., a consulting firm specializing in issues pertaining to public utilities. Dr. Swan holds a B.S. degree in Business Administration from Ithaca College. He attended a master's program in economics at Tufts University, and holds a Ph.D. in economics from the University of North Carolina at Chapel Hill. Dr. Swan has over 30 years of experience in long-term electric power supply planning, contract negotiations for large power users, and on electric utility cost allocation and rate design.

The OCA excepts to each of these determinations of the ALJ. The OCA submits that the ALJ erred in not adopting the OCA's recommendation to use a 10.1% return on equity in setting the SMC when there has been no recent fully-litigated base rate proceeding. The OCA recommended the 10.1% return as an interim step until the Commission can conduct a generic proceeding to establish a process for using the FUS Quarterly Reports to set an equity return in the absence of a recently litigated cost of equity determination. Inasmuch as the ALJ's ruling does not specify which of a range of equity returns from the Quarterly Earnings Report is to be used, it supports the need for conducting a generic proceeding before these reports are used for cost recovery purposes.

The OCA submits that the ALJ erred in accepting the Company's proposed equity ratio of 59% as part of its capital structure for use in calculating the SMC. Just as the ALJ rejected the Company's proposed equity return of 10.9% as inappropriate because it derived from the settlement of a FERC case, so he should have rejected the equity ratio from the same FERC case. Moreover, the OCA demonstrated that the 59% figure was outside the reasonable range of comparable companies. Instead, the Commission should adopt the 51% figure recommended by the OCA.

The OCA further submits that the ALJ erred in his decision to reject the OCA's allocation methodology for common costs and in his adoption of the OSBA's alternative method. In rejecting the OCA's method, the ALJ commented that the proposal was "theoretical and speculative" in regard to customer benefits, that it was not based on "reasonable cost of service practices," and that it resulted in an "unreasonable allocation of the common costs to the multi-phase meter group." I.D. at 19. It is the OCA's position that traditional cost of service principles, the language of Act 129, and the Commission's Implementation Order, all support the OCA's proposed allocation method. As the OCA demonstrated in its testimony and briefs, and will also demonstrate in these Exceptions, the OCA allocation method is fully consistent with cost of service principles as it assigns costs on the basis of cost causation. Further, the OCA method is neither theoretical nor speculative as the OCA has produced substantial practical evidence on the instant record to support the method it has proposed.

In adopting the OSBA's alternate proposal for allocation of common costs, the ALJ again fails to reflect the actual cause of these costs – the energy and demand reductions that are expected to result from implementation of Duquesne's smart meter plan.

The OCA therefore respectfully urges the Commission to reject the ALJ's decisions in each of the three areas identified: cost of equity, equity capitalization ratio and the allocation of common costs, and to adopt the OCA's recommendations in each.

Finally, the OCA seeks clarification of the ALJ's determination with respect to the rate base valuation to be used when calculating the forward-looking quarterly updates to the SMC that have been proposed by the Company.

## II. EXCEPTIONS

OCA Exception No. 1: For purposes of clarification, the OCA excepts to the ALJ's determination regarding rate base valuation for quarterly SMC updates. (I.D. at 21-22; OCA R.B. at 18)

At page 21 of the I.D., the ALJ accurately recounts the positions of Duquesne and the OCA with respect to the treatment of investment at the time of the annual reconciliation of the SMC. In the context of the annual reconciliation, Duquesne and the OCA agree that the actual timing of when an investment is placed in service should be recognized. Where the Company and the OCA disagree, however, is on the valuation of rate base to be used in setting the SMC prospectively. Duquesne indicates its intention to update the SMC quarterly and for this purpose to use the projected end-of-quarter plant in service value. Duquesne Exh. D-R at 4. As the OCA noted in its Reply Brief, using the projected end-of-quarter rate base will invariably lead to over-recovery as the end-of-quarter plant will exceed the actual plant balance over the course of the quarter and over the year. OCA R.B. at18. As a result, the OCA argued that it would be more appropriate to use the projected average plant balance for the quarter when setting the SMC prospectively.

In the I.D., the ALJ did not address this issue. The ALJ states as follows:

> In my opinion the consideration of actual, historic plant in service and projected plant in service during the reconciliation of the SMC would be similar or analogous to the consideration of historic and projected gas costs in a proceeding under Section 1307(f) of the Code [citation omitted]. Accordingly, Duquesne should be permitted, as part of the annual reconciliation to calculate the prospective SMC on the basis of historic and projected plant in service.

I.D. at 22.

Thus, the ALJ determined that Duquesne should set its prospective SMC on the basis of historic and projected plant in service, but does not address whether the projected plant in service should be valued at the projected end-of-quarter level or at the level of the projected average plant balance for the quarter. Because the ALJ did not address this issue, the OCA excepts to this portion of the I.D. for the purpose of seeking a determination from the Commission on this point.

To that end, it is the OCA's position that setting the rate on the basis of projected average plant balance, as recommended by OCA witness Catlin, will ensure that the costs recovered from customers over the course of the quarter the rate is in effect will most closely match the costs incurred and will minimize the annual over and under recoveries that are experienced when the annual reconciliations are conducted.

Duquesne sought to support its proposal to use end-of-quarter plant-in-service projections by noting that Pennsylvania is a "terminal rate base state." Duquesne M.B. at 25. The OCA is unsure of the meaning of the phrase "terminal rate base state," but suspects that it refers to the fact that in Pennsylvania base rate proceedings, the end of future test year rate base is what is used in setting rates. It must be remembered, however, that the future test year is normally over or close to being over by the time new rates go into effect. The OCA submits that the use of a terminal or end of period rate base is not meaningful when rates are being set prospectively and revenues and costs are fully reconciled on an annual basis. Employing an end of period rate base will only result in over-recoveries that will have to be refunded to ratepayers.

As noted, the OCA respectfully requests a ruling from the Commission on this point and submits that, for the reasons cited, the most appropriate rate base value to use when setting the SMC prospectively is the projected average plant balance for the quarter for which the rate is being set.

OCA Exception No. 2: <u>The ALJ Erred In Not Accepting the OCA's Recommendation That A 10.1% Return On Equity Be Used For Computing the SMC Until Such Time as the Commission Conducts a Generic Proceeding to Establish the Procedure for Determining the Return on Equity to be Used When There Has Been No Recently Litigated Base Rate Case</u>. (I.D. at 24-28; OCA M.B. at 23-25; OCA R.B. at 19-22)

For purposes of setting its SMC, Duquesne proposed to use the cost of common equity and equity capitalization ratio agreed to in the settlement of its transmission formula rate proceeding before the Federal Energy Regulatory Commission (FERC) in Docket No. EL06-109-000. In that case the settlement permitted a return on common equity of 10.9% and a common equity capitalization ratio in a range from 45% to 59%. Duquesne proposed to employ the top figure in that range as its common equity ratio for purposes of calculating the SMC.

Duquesne Exh. D at 6-7; Exh. WVP-2 at 2. The OCA opposed the use of the values from a settled FERC proceeding as being inappropriate for use in this Pennsylvania ratemaking proceeding. OCA St. 2 at 4.

The OCA, through its witness Mr. Catlin, offered a three-part alternative to the Company's proposal. A key element of Mr. Catlin's proposal, as will be further explained, was to immediately set an interim return on equity of 10.1% for use in calculating the SMC. The first part of Mr. Catlin's proposal was that if Duquesne has had a fully litigated PUC base rate case within three years of the effective date of the time Duquesne seeks to update its SMC, then the common equity return established in that case should be used for SMC purposes. Second, if more than three years have passed since the Company's last fully litigated rate case, Mr. Catlin proposed that the equity return should be based on the most recent FUS "Report on the Quarterly Earnings of Jurisdictional Utilities" (Quarterly Earnings Report). OCA St. 2 at 5-6. However, Mr. Catlin issued a caveat to the use of the equity returns from the Quarterly Earnings Report. He stated:

> In reviewing the Quarterly Earnings Reports for the past several years, I noted that the discounted cash flow (DCF) returns and the overall equity cost rates for electric utilities have been inconsistent and volatile. Therefore, the existing electric utility returns published in the Quarterly Earnings Reports do not appear to be appropriate for use in establishing the return on equity to be used for Duquesne's and other electric distribution utilities' (EDCs') smart meter charges.

OCA St. 2 at 6. Given this concern, Mr. Catlin recommended adopting the procedure used by the Commission in setting an equity return for water utilities that impose a Distribution System Improvement Charge (DSIC). Further, he recommended that the procedure for calculating the return applicable to EDC Smart Meter Charges be the subject of a generic proceeding. Mr. Catlin testified:

> After the Commission approved the use of DSICs by water utilities, the Commission Staff/Bureau of Fixed Utility Services (FUS) began developing and publishing a return on equity explicitly for use in determining allowed DSIC returns. Consistent with that approach, I would recommend that the Commission direct the FUS to begin publishing a return on equity that would be specifically applicable for smart meter charges (SMCs) in instances where an EDC has not had a base rate case in three years. The procedure for calculating that return on equity should be established through a generic proceeding in which the FUS participates. It would be appropriate for the return established in that proceeding to reflect the lower risk associated with the guaranteed recovery of all smart meter costs through a fully reconcilable surcharge.

OCA St. 2 at 6.

The third part of Mr. Catlin's cost of equity proposal was that until such time as the Commission establishes the appropriate equity rate of return through a generic proceeding or a more recent equity return is available from a Duquesne-specific distribution base rate case, the equity return that should be used in calculating Duquesne's SMC is that which was established in the most recent fully litigated base rate proceedings among Pennsylvania EDCs, the 2006 (decided in early 2007) rate cases of Metropolitan Edison Company(Met-Ed) (Docket No. R-00061366) and Pennsylvania Electric Company (Penelec) (Docket No. R-00061367). In those cases, the Commission authorized a return on equity (ROE) of 10.1%. OCA St. 2 at 7. The OCA recommended use of 10.1% in this proceeding because Duquesne has not had a litigated rate case since 2004 and a generic proceeding for determining a procedure for the use of the Quarterly Earnings Reports has not yet been conducted.

In the I.D., the ALJ agreed with the OCA that the Company-proposed cost of equity (10.9%) from the FERC proceeding should not be used. I.D. at 27-28. The ALJ further agreed with the OCA that the preferred ROE to be used for calculating the SMC should be that established by the Commission in a fully-litigated rate case, provided the case was concluded within three years of the effective date of any proposed SMC update. The ALJ went on to recommend that as a check on the Commission-determined equity figure, it should be compared to the equity returns for electric utilities in the FUS Quarterly Earnings Report. The ALJ recommended that if the equity returns in the Quarterly Earnings Report vary by more than 0.50% above or below the return set in the fully-litigated rate case, the lower of the two rates should be used for calculating the SMC. I.D. at 28. The ALJ further stated that if Duquesne has not had a fully-litigated rate case within three years of the effective date of a change in the SMC, then the equity returns for electric utilities in the Quarterly Earnings Report should be used as a proxy for the Company's equity return when calculating the SMC and should continue to serve as a proxy until replaced by a Commission-determined return established in a fully-litigated rate case. Id. The ALJ specifically rejected the OCA's recommendation for a generic proceeding to determine the method for calculating the proxy ROE to be used in setting SMCs and further rejected the OCA's recommended 10.1% equity return for use until there is a litigated base rate case or until a generic proceeding is conducted. Id.

The OCA excepts to the ALJ's rejection of the OCA's recommendation to use 10.1% as an interim equity return. As noted above, this is the return on equity (ROE) determined in the last fully-litigated electric utility base rate cases conducted in Pennsylvania, the 2006-07 Met-Ed and Penelec cases. In the absence of a more recent fully-litigated Duquesne case, and in the absence of a Commission-determined figure to be relied upon from the Quarterly Earnings Report, the OCA submits that its interim rate recommendation is the only one that has been put forth by any party and that the rate is both reasonable and supportable. For those reasons, the Commission should adopt 10.1% as the interim ROE for Duquesne until superseded by the ROE from a litigated rate case or replaced by a rate from the Quarterly Earnings Report established by way of a generic proceeding.

Moreover, the ALJ erred in recommending the use of the Quarterly Earnings Reports without first recommending a generic proceeding to establish a procedure for determining a proxy equity return to be used when there has been no recently litigated base rate case. The ALJ stated that he "was not convinced that such a procedure would be appropriate for this charge." Id. However, OCA witness Catlin testified to the volatility he observed in the equity returns for electric utilities in the Quarterly Earnings Reports in recent years. He also identified an example of an issue that could be appropriately addressed in a generic proceeding – whether the equity return used for calculating the SMC should reflect the lower risk associated with the guaranteed recovery of all smart meter costs through a fully reconcilable surcharge. Such a consideration is not typically reflected in the equity rates of return currently shown in the Quarterly Earnings Reports. Finally, there is currently a lack of transparency surrounding the details of the FUS' electric company barometer group and the calculations that are used to produce the return figures presented in the Report. A generic proceeding involving interested stakeholders would solve transparency concerns, address issues unique to the SMC and yield a procedure that would dampen volatility to the extent possible.[4]

---

4 The OCA submits that further evidence of the need for a generic proceeding arises from the fact that the ALJ does not specify which of the several rates of return set forth in the Quarterly Earnings Report should be used for setting SMC rates when there has been no full-litigated rate case within three years. The only Quarterly Earnings Report available in the record of this case is that introduced as Duquesne Cross Examination Exhibit 1, which is the FUS report for the period ended June 30, 2009. A review of page 12 of that report, titled Market Based Returns on Common Equity, Electric Company Barometer Group, reveals a number of different equity cost rates. Among those potentially relevant for use as a proxy for setting the SMC are the rate on line 1, Current DCF, line 2, 52-week average DCF, line 3 Overall DCF, and line 7, Overall Cost Rate. Also potentially relevant would the range of equity returns set forth on line 8, Market Indicated Common Equity Cost Rate Range. The I.D. provides no guidance on which of these various rates of return should be used as the proxy for setting the SMC or for use as a comparison to a Commission-determined rate, as recommended by the ALJ. The range of the potentially relevant figures in the Quarterly Earnings Report is wide, from 7.44% to 11.29%. The OCA submits that a generic proceeding would assist the Commission in arriving at the most appropriate return figure to be used for SMC purposes.

For the foregoing reasons, the Commission should direct that a generic proceeding be held to establish a proxy ROE for setting EDC SMC rates when there has been no recently litigated base rate case and until such a proceeding is completed, the Commission should adopt the OCA's recommended interim proxy rate of 10.1%.

OCA Exception No. 3: The ALJ Erred In Adopting Duquesne's Claimed Equity Ratio of 59% For Purposes of Setting the SMC. (I.D. at 29-31; OCA M.B. at 26-28; OCA R.B. at 22-24)

In the I.D., the ALJ determined that Duquesne had established the reasonableness of its claimed 59% equity ratio for use in SMC recovery proceedings, and recommended that the Commission allow the 59% to be used so long as Duquesne's actual equity ratio exceeds that level. I.D. at 31. In reaching his conclusion, the ALJ rejected OCA witness Catlin's recommendation for a proxy equity ratio of 51%, which was the common equity ratio established in the 2006-07 Met-Ed and Penelec base rate cases, the last fully litigated electric rate proceedings in Pennsylvania. Id. Mr. Catlin explained his rationale for proposing the 51% figure as follows:

> Until such time as Duquesne has a base rate case in which capital structure can be addressed, a proxy equity ratio must be used. Consistent with my recommendation to utilize the ROE approved for Met-Ed and Penelec on an interim basis, it is my recommendation that the 51 percent equity ratio approved for those companies also be utilized on an interim basis. I would note that this is above the 45 percent equity ratio explicitly agreed upon in the settlement of Duquesne's most recent rate case in Docket No. R-00061346 in late 2006 and is within the range of comparable companies shown on Schedules TSC-1 and TSC-2.

OCA St. 2 at 8.

The OCA excepts to the ALJ's adoption of the 59% common equity ratio. Initially, it must be recalled that Duquesne's claim for a 59% common equity ratio came from its FERC transmission formula rate proceeding in which, pursuant to the settlement of that case, the

Company was permitted to use a common equity ratio in a range between 45% and 59%. Duquesne Exh. D at 7. In this proceeding, Duquesne has proposed to use the top end of that range, 59%. Duquesne M.B. at 29; Duquesne Exh. WVP-2, p. 2. As discussed above, Duquesne also proposed to use the return on equity (10.9%) established in the FERC settlement. Duquesne Exh. D at 7.

The OCA opposed using the equity parameters from the FERC settlement on the ground that those values were agreed upon as part of an overall settlement of the FERC case. The case was not fully litigated and the settlement terms were not intended to be used for Pennsylvania ratemaking purposes. OCA St. 2 at 4; OCA M.B. at 24. Indeed with respect to the return on common equity, the ALJ agreed with the OCA and rejected the Company's proposed 10.9% equity return from the FERC proceeding. The ALJ stated:

> I do not accept Duquesne's 10.9% return on equity from its settled FERC proceeding. In my opinion a figure accepted by an adjudicatory body in approving a settlement is not entitled to the same weight as return on equity rate determined to be reasonable following full litigation of that issue.

I.D. at 27-28. The OCA submits that the same reasoning that led the ALJ to reject the use of the return on equity from the FERC proceeding should have led him to reject the equity ratio agreed upon in that proceeding as well.

In its testimony and briefs, the OCA also cited a provision from the settlement of Duquesne's merger proceeding with the Macquarie Consortium (Docket No. A-110150F0035) in which Duquesne agreed not to request a capital structure for ratemaking purposes that is outside a reasonable range of that used by comparable companies. The exact language of the provision is as follows:

> Duquesne shall not request a capital structure for ratemaking purposes which is outside of a reasonable range of that used by

> comparable companies. In any future base rate proceeding, Duquesne must demonstrate that its claimed common equity ratio is reasonable and in the best interests of its customers. (Paragraph III.B.3.a.)

OCA St. 2 at 7-8; OCA M.B. at 26. The OCA relied on this language to argue that Duquesne made no showing in this case that its proposed 59% equity ratio was consistent with the range used by comparable companies. OCA M.B. at 26; OCA St. 2 at 8. The ALJ dismissed the OCA's argument stating that, "As this is not a base rate proceeding, the "limitation" in the Macquarie settlement petition is not applicable to Duquesne's claimed capital structure in this case." I.D. at 31. While it is true that the instant case is not a base rate case, the OCA notes that the first clause of the merger settlement provision states "for ratemaking purposes" There can be no question that setting the SMC constitutes ratemaking as it is setting a rate that Duquesne customers must pay. Duquesne has not shown that its capital structure or its claimed equity ratio is reasonable or within the reasonable range of comparable companies.

With respect to whether indeed Duquesne's claimed equity ratio falls within a reasonable range of comparable companies, the OCA submitted two schedules, TSC-1 and TSC-2, appended to the Direct Testimony of its witness Thomas S. Catlin, OCA St. 2. In TSC-1, Mr. Catlin shows the common equity ratios for seven electric utility companies that, like Duquesne, are primarily distribution-only utilities. In TSC-2, Mr. Catlin shows the common equity ratios for the six companies used as the electric utility barometer group in the FUS Quarterly Earnings Reports. The equity ratios in TSC-1 range from 46.4% to 54.6%, and in TSC-2, they range from 42.6% to 58.6%. In a footnote to both schedules, Mr. Catlin noted that his equity ratio figures were taken from the *Value Line Investment Survey*, which excludes both short-term debt and current maturities of long-term debt. At the evidentiary hearing, Mr. Catlin testified that it was his belief that the Commission typically does not exclude current maturities of long term debt when determining equity ratios. Tr. at 133. Therefore, it can be argued that the figures set forth in TSC-1 and TSC-2 are to some degree overstated, based on the Commission's typical method for calculating equity ratios. Taking into account that the figures may be somewhat overstated, it becomes clear that Duquesne's proposed 59% equity ratio is outside the range applicable to comparable companies. Further, if one considers that of the two schedules, TSC-1 contains companies more comparable to Duquesne, as they are all primarily distribution-only utilities, then Duquesne's 59% appears even more of an outlier.

For the same reason the ALJ rejected the use of the return on equity from the FERC proceeding for Pennsylvania ratemaking purposes, he should also have rejected the use of the common equity range agreed upon in that proceeding. Moreover, the settlement provision in Duquesne's merger proceeding with Macquarie requires Duquesne to demonstrate that its equity ratio was within a reasonable range of comparable companies. The OCA has demonstrated that Duquesne's proposed equity ratio is not within such a range. For all of these reasons, the OCA respectfully requests the Commission to reject the ALJ's adoption of the Company's claimed 59% common equity ratio and in the absence of a properly justified proposal from the Company, to adopt the OCA's proposal for a proxy equity ratio of 51%. The OCA's proposal based on the most recently litigated electric base rate case and is consistent with the range of comparable companies reflected in TSC-1.

OCA Exception No. 4: The ALJ Erred In Rejecting the OCA's Approach to the Allocation of Common Smart Meter Costs. (I.D. at 15-20; OCA M.B. at 29-44; OCA R.B. at 5-17)

A. Introduction

Duquesne proposed to allocate the costs of smart meter deployment by first dividing its customer base into two groups, those on single-phase meters and those on multi-phase meters.

The cost of the meter itself would be directly assigned to each group. Costs which the Company considered to be "common" to both types of meters, such as the cost of infrastructure to collect, back haul and store data, would be allocated to each group based on the number of meters. Duquesne Exh. D at 9.

The OCA objected to the allocation of common costs on the basis of number of meters. As an alternative, the OCA proposed that common costs should be allocated based on energy and demand since the purpose of the massive investment in smart meters is to provide energy usage savings and peak demand savings for customers in order to mitigate energy prices and energy price volatility. OCA St. 3 at 8-9. As support for its position, the OCA cited the preamble to Act 129 which states that one of the main goals of the Act is to reduce the cost and price instability of electric energy:

> The General Assembly recognizes the following public policy findings and declares that the following objectives of the Commonwealth are served by this act:
>
> (1) The health, safety and prosperity of all citizens of this Commonwealth are inherently dependent upon the availability of adequate, reliable, affordable, efficient and environmentally sustainable electric service at the least cost, taking into account any benefits of price stability over time and the impact on the environment.

Act 129, 66 Pa.C.S. § 2806.1 *et seq*, pmbl. As the OCA pointed out in its Main Brief, the purpose of this substantial investment in smart meters is not simply to count kilowatt hours and render accurate bills to each individual customer. Rather, it is to reduce overall demand and energy costs for the benefit of all customers. Allocating the common costs of the smart meter program on the basis of energy and demand recognizes the purpose of Act 129 and the cause of the incurrence of these costs. OCA M.B. at 30.

The Commission's Smart Meter Procurement and Installation Implementation Order, Docket No. M-2009-2092655 (Order entered June 24, 2009) (Implementation Order) also recognized this important principle. There the Commission stated:

> The Commission will require that all measures associated with an EDC's smart metering plan *be financed by the customer class that receives the benefit of such measures*. In order to ensure that proper allocation takes place, it will be necessary for the utilities to determine the total costs related to their smart metering plans, as discussed in E.1. Once these costs have been determined, *we will require the EDC to allocate those costs to the classes whom derive benefit from such costs*. Any costs that can be clearly shown to benefit solely one specific class should be assigned wholly to that class. Those costs that provide benefit across multiple classes should be allocated among the appropriate classes using reasonable cost of service practices.

Implementation Order at 32. *(Emphasis added)*

The OCA argued that instead of allocating common costs on the basis of the number of meters, these costs should be allocated to the meter groups in some reasonable proportion to the benefits received by each group from the planning and implementation of the smart meter system. Such an approach is consistent with the language of Act 129 which makes clear that one of the principal goals of the Act is to reduce the cost and price instability of electric energy and it is also consistent with the Commission's intention to assign costs to the those customer classes that derive the benefit. OCA M.B. at 31-32. OCA witness Dr. Swan testified that the benefits realized by the two meter groups identified by the Company would be in proportion to the amount of energy and capacity used by the two groups. OCA St. 3 at 8. He noted that based on information supplied by the Company, a significant portion of the benefits to be realized will take the form of reduced energy costs and avoided capacity and transmission costs. Id.

In the I.D., the ALJ rejected the OCA's proposed approach to cost allocation stating that it is "both theoretical and speculative as to which and how customers in the various classes will "benefit" from the [Smart Meter Program] and, in my opinion, is not based on reasonable cost of service practices." I.D. at 19. The OCA excepts to the ALJ's conclusion. The OCA's recommended method for allocating common costs is based on reasonable cost of service principles and is not speculative.

## B. The OCA's Proposed Cost Allocation Method Adheres to Cost of Service Principles

Initially, the OCA excepts to the ALJ's assertion that the OCA's method of cost allocation is not based on reasonable cost of service practices since it considers the benefits of smart meter deployment. The OCA submits that its proposed method is fully consistent with cost of service principles. OCA witness Swan addressed the assertion that there can be no consideration of benefits in determining cost of service in both his Direct and Surrebuttal Testimony. In his Direct Testimony, Dr. Swan explained:

> The underlying tenet of cost of service studies is to allocate common costs among the classes in proportion to the extent to which the classes have caused those costs to be incurred. In the case of a smart metering system, what causes the costs to be incurred are the benefits that are expected to be derived from the deployment of such a system. Thus, we need to look carefully at why these costs are being incurred—that is, what benefits are anticipated to be derived from these costs. Then, we need to carefully assess the extent to which the various customer classes will reap these benefits.

OCA St. 3 at 3.

In his Surrebuttal Testimony, Dr. Swan further explained:

> The fundamental rule in cost of service studies is to allocate costs based on the cause of the costs. The costs at hand would not be incurred if it were not for the expectation that benefits will be realized from the incurrence of those costs. As the expected benefits are what will cause those costs to be incurred, it is fully consistent with normal cost allocation practice to allocate the costs on the expected distribution of those benefits.

OCA St. 3-S at 9 -10.

Also in his Surrebuttal Testimony, Dr. Swan countered the assertion by DII witness Richard A. Baudino that Dr. Swan's allocation proposal was similar to a "value of service" pricing theory:

> Like Mr. Pfrommer, Mr. Baudino concludes that these common costs should be allocated based on the number of customers without asking the fundamental question why these costs are going to be incurred in the first place. As I stated in my direct testimony, the General Assembly made clear that one of the main goals of Act 129 was to reduce the cost and price instability of electric energy for customers. That is, the General Assembly has required that Pennsylvania distribution utilities incur these costs to bring about savings for its customers. That requires that one look beyond mechanical cost allocation approaches to determine the factors that caused these costs to be incurred in the first place. The Commission explicitly recognized this relationship in its June 18, 2009 Implementation Order when it stated that "...we will require the EDC to allocate those costs to the classes whom derive benefit from such costs."
>
> Mr. Baudino fails to ask what factors caused these costs to be incurred in the first place, which is fundamental in observing reasonable cost of service principles. In so doing, I believe he ignores the dictates of the Commission in requiring that costs be allocated to the classes whom derive benefits from those costs.

OCA St. 3-S at 7. Hence, Dr. Swan makes clear that his method of cost allocation is grounded in fundamental cost of service principles.

In the I.D., the ALJ references the argument made by DII that Duquesne's proposed cost allocation method was based on the Company's cost of providing service and was consistent with established precedent. I.D. at 18. The ALJ noted that DII cited the case of Lloyd v. Pa.PUC, 904 A.2d 1010 (Pa. Commw. Ct. 2006). DII argued that Lloyd established cost of service as the "polestar" of utility ratemaking and that the OCA's cost allocation method violated Lloyd because it was not based on cost of service. What DII failed to mention, however, is another section of the Lloyd decision which upheld the allocation of Sustainable Energy Fund (SEF) costs to all distribution ratepayers on the basis that all ratepayers benefit from the Fund's activities. Lloyd, Id. at 1024-1027. The SEF costs were charged to all customers on an equal cents per kilowatthour basis, *i.e.*, an energy basis. In the face of an argument by industrial customers that the SEF provided no demonstrable benefits to ratepayers, the Court stated: "What the core of that argument ignores is that the General Assembly has specifically authorized that public service programs such as SEF be funded." Lloyd, Id. at 1025. The Court noted that the purpose of the SEF is "to promote the development and use of renewable energy and clean energy technologies, energy conservation and efficiency which promote clean energy." Lloyd, Id. at 1024. Act 129, which established the Smart Metering program, likewise seeks to further the availability of adequate, reliable, affordable, efficient and environmentally sustainable electric service at the least cost, taking into account the benefits of price stability over time and the impact on the environment. 66 Pa.C.S. § 2806.1, *et seq.* preamble.

In its Main Brief, the OCA cited a case from the U.S. Seventh Circuit which also indicated that the causal relationship between costs and benefits is an accepted cost of service principle. The Seventh Circuit stated:

> FERC is not authorized to approve a pricing scheme that requires a group of utilities to pay for facilities from which its members derive no benefits, or benefits that are trivial in relation to the costs sought to be shifted to its member...Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party.

Illinois Commerce Commission v. FERC, 576 F.3d 470, 476 (Seventh Cir. 2009) (citing KN Energy, Inc. v. FERC, 968 F.2d 1295, 1300, (D.C. Cir. 1992); Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 708 (D.C. Cir. 2000); Pacific Gas & Elec. Co. v. FERC, 373 F.3d

1315, 1320-21 (D.C. Cir. 2004); Midwest ISO Transmission Owners v. FERC, 373 F.3d 1361, 1368 (D.C. Cir. 2004); see also Alcoa Inc. v. FERC, 564 F.3d 1342, 1346-47 (D.C. Cir. 2009); Federal Power Act, 16 U.S.C. § 824d). In Illinois Commerce Commission case, the Court heard an appeal from various Commissions and utilities in PJM regarding the financing of new transmission facilities. ICC, 576 F.3d at 474. The PJM-proposed and FERC-approved method at issue would have required all utilities in PJM's region to contribute pro rata for facilities of over 500kV. Id. In overturning this treatment, the Seventh Circuit noted that not even the roughest estimate of likely benefits to the objecting utilities was presented. ICC, 576 F.3d at 475. In fact, FERC counsel conceded that Commonwealth Edison would derive only $1 million in expected benefits from the project for which it was being asked to pay $480 million. Id. at 478. The Court specifically stated that the disparity between benefit and costs would be unreasonable. Id.[5]

Dr. Swan addressed this causal relationship very effectively in the summary to his Surrebuttal testimony:

---

[5] Similarly, the PJM Interconnection and the Midwest Independent Transmission System Operator (MISO) proposed a methodology for allocating the costs of projects built into one regional transmission organization that also provided benefits to another Regional Transmission Operator (RTO). These benefits are referred to as "economic cross-border projects." In its Order addressing this issue, the FERC described the methodology it then approved as follows:

> If a project qualifies as an economic cross-border project, its costs will be allocated to each RTO in proportion to the present value of the RTO's share of the annual benefits that are calculated for the proposed project...
>
> We accept the RTO's proposal as just and reasonable and in compliance with the Commission's directives to revise the JOA [Joint Operating Agreement] to include a methodology to allocate between the RTOs, the costs of economic cross-border transmission projects.
>
> We find that the proposed JOA economic cross-border benefit formula is a just and reasonable method of allocating costs since it is based on criteria that the Commission previously accepted for use by each RTO to measure the benefits of adding new transmission within its footprints.

Order on Cross-Border Facilities Cost Allocation, 129 FERC ¶ 61,102 at ¶¶ 9, 26-27 (2009).

> I think the General Assembly was quite clear in its reasons for requiring Pennsylvania's distribution utilities to incur the costs of a smart meter system – to reduce the cost of energy and to minimize the volatility of energy prices. I also think the Commission was clear in its desire that distribution utilities allocate costs to those classes that will benefit from the incurrence of the costs of a smart meter system. I do not think that the Commission's directive to use reasonable cost of service practices to allocate costs that benefit multiple classes is inconsistent at all with the recognition of which classes will benefit from the incurrence of these costs. Reasonable cost of service practices do seek to identify the causes of the costs incurred. Some hard thinking can only lead one to conclude that it is the expected realization of benefits that have caused these costs to be incurred in the first place.

OCA St. 3-S at 12-13.

Dr. Swan went on to recognize the fundamental equity of the cost allocation approach he has advanced:

> I think there is also a fundamental question of equity involved in this decision. It is illogical to suggest that customers with single phase meters will receive 96.2 percent of the benefits of implementing Duquesne's smart meter plan and that customers with poly-phase meters will receive only 3.8 percent of the benefits. Yet that is how Duquesne proposes to allocate the common costs of the plan. Simple fairness, as well as sound cost of service principles, dictate that a more reasonable allocation of these costs among the customer groups be implemented, such as the use of the broader energy and peak demand allocator that I have proposed.

OCA St. 3-S at 13.

The OCA proposal for allocation of the common smart meter costs is fully consistent with fundamental cost of service principles, is in accord with Lloyd, the aims of Act 129 and the Implementation Order, and achieves equity in the distribution of costs among the customer classes. For these reasons, the OCA method should be adopted by the Commission.

## C. <u>The OCA's Proposed Cost Allocation Method is Not Theoretical and Speculative</u>

The ALJ characterized the OCA's allocation proposal as theoretical and speculative. I.D. at 19. The OCA submits that the OCA has produced substantial practical evidence on this record to support its position that the benefits to be derived from smart meters will take the form of energy and demand savings and that those benefits will accrue to the various classes of customer in proportion to their energy and demand use.

OCA witness Dr. Dale E. Swan testified to the purpose of the Company's Smart Meter Program:

> … the Company's Smart Meter Plan (the Plan) and its application for Federal assistance under the American Recovery and Reinvestment Act (ARRA) both identify other longer term benefits that will accrue to the Company and its customers. These benefits primarily take the form of reductions in energy use and peak period capacity utilization. In response to OCA Data Request IV-4, the Company stated:
>
> > The Company agrees that the implementation of a smart meter system and customer participation in dynamic pricing programs, including time-of-use, real time and critical time pricing options provide an opportunity for customers to reduce their energy costs and reduce PJM capacity and transmission costs.
>
> In its ARRA application, the Company includes the following in its list of benefits that will accrue to Duquesne or its customers as a result of the implementation of its smart meter program:
>
> > - Reduce electric consumption by permitting increased energy efficiency and conservation;
> > - Reduce demand for peak electrical power;
> > - Improve demand forecasting to assist with medium and long term infrastructure planning;

> - Facilitate the introduction of innovative pricing mechanisms; and
>
> - Increase system reliability by predicting trouble spots, lowering demand during peak periods thereby reducing stress on the system, and assisting with faster restoration of service. (Citation omitted)

OCA St. 3 at 3-4.

In his Exhibit DES-1, Dr. Swan provided the number of customers, total energy consumed and the peak demands for customers using single-phase meters and those using multi-phase meters. For example, while the multi-phase meter group is responsible for 63% of total energy usage and either 53% or 54% of peak demand (depending on whether a 1-Coincident Peak or 5-Coincident Peak allocation method is used), the Company has proposed to allocate only 3.8% of the common costs to the multi-phase meter group because that is their share of the total number of meters. Duquesne Exh. D, Exh. WPV-2. In contrast, single-phase meter customers are responsible for 37% of energy usage and 46% or 47% of peak demand, yet they will bear 96.2% of the total common costs because that is their share of the total number of meters. Id. The OCA submits that it defies logic to suggest that the multi-phase meter group will receive only 3.8 percent of the benefits of Duquesne's smart meter program as the savings for customers will be substantially in proportion to the amount of energy and capacity used by those customers.

The common costs at issue in this proceeding do not benefit one class solely nor do they benefit all classes equally. The OCA submits that it is simply inappropriate to allocate the exact same dollar level of these costs to an individual 500 kWh per month residential customer as to the largest industrial or commercial customer on the Duquesne system.

As further support for the proposition that smart meter benefits will not be equally distributed, Dr. Swan cited information from the Duquesne's own ARRA proposal that included specific initial estimates of benefits accruing to each customer class. OCA St. 3 at 7. For Duquesne's initial meter installation, Large C&I customers are estimated by Duquesne to receive 67 to 69 percent of the savings; Medium C&I customers 27 to 28 percent of savings; and residential customers only 2.7 to 5.5 percent of the savings. Dr. Swan concluded:

> Thus, the Company's own estimates of the distribution of benefits from the investment in these common costs confirm that some measure of usage should be used to allocate these costs among the two groups of customers and not the number of meters.

OCA St. 3 at 8.

Dr. Swan also testified that the Company anticipates smart metering benefits to derive from customer participation in dynamic pricing programs, including time-of-use, real time and critical time pricing options. Dr. Swan explained that participation in these types of programs, although available to everyone, will likely be much higher among Large C&I customers than among residential customers because of the nature of the Large C&I customers. Id. Large C&I customers are much more sophisticated electricity consumers and they often have staff that are dedicated to managing their firm's energy use since the cost of energy to these firms will have significant impacts on the bottom line. Dr. Swan further explained:

> Moreover, the savings to these customers from participation in these programs will be in proportion to their energy use or their peak demands. Even if the participation rates in these programs were the same among all the classes, which they will not be, the average benefit per customer will be significantly higher for the largest C&I customers than for the much smaller residential customers. It is naive to assume that the benefits will be the same for all customers, and it is erroneous to conclude that these common costs should be allocated on the number of customers.

OCA St. 3 at 6.[6]

The OCA submits that it has presented substantial practical evidence to support its proposal for allocation of common costs. None of this evidence was from the theoretical realm. All was based on information found in the Company's filing, in its application for ARRA funding, in Company responses to OCA data request and on well-established patterns of customer behavior. The OCA respectfully submits that the ALJ's characterization of its cost allocation methodology as theoretical and speculative is simply in error.

D. The OCA's Proposed Cost Allocation Method Does Not Result in an Unreasonable Allocation to the Multi-Phase Meter Group

The ALJ also characterized the OCA's allocation method as resulting in "an unreasonable allocation of the common costs to the multi-phase meter group," consisting primarily of commercial and industrial customers. I.D. at 19. In reaching this conclusion, the ALJ appears to be more concerned with the results of the allocation method, than with the method. As the

6 Duquesne and DII have argued that Large C&I customers will not see additional benefits from the installation of smart meters as the Large C&I class already has interval meters and the benefits to be gained from the new smart meters have largely been realized by these customers. Duquesne M.B. at 23; DII M.B. at 9-10. This argument ignores the fact that the smart meter technology that Duquesne will install will expand the options available to the Large C&I class. See OCA M.B. at 42; OCA St. 3-S at 6-7. If this were not the case, then the smart metering aspect of Act 129 would serve no purpose. This expansion will include programs beyond those offered by PJM and will include a full menu of dynamic pricing options. Further, the increased information about usage that will result from the new smart meters will bring competition with many more pricing options specific to each Large C&I customer's level of usage. Indeed, Constellation New Energy and Constellation Energy Commodities Group (Constellation) filed testimony in this proceeding addressing how the new smart meter technology will increase the amount of data being collected and will allow EGSs to better understand usage patterns and help C&I customers with functions such as energy efficiency and peak load reductions. Constellation St. 1 at 8-10. Further, in its Main Brief, Constellation argued for 15-minute interval data to be made available to EGSs on an *hourly* as opposed to a *daily* basis to allow all C&I customers to take advantage of new energy infrastructure and shape new energy and resource management innovation. Constellation M.B. at 16.

The testimony and brief of Constellation provide persuasive evidence that, contrary to the arguments of Duquesne and DII, the benefits of smart metering have not been fully tapped by C&I customers. To argue that the Large C&I customers have already reaped all of the benefits of smart meters is simply incorrect.

OCA has demonstrated (*see* OCA Exh. DES-1), commercial and industrial customers account for the majority of usage and demand on the Duquesne system and therefore will receive the majority of benefits from the common costs that will be incurred to implement the smart meter program. It is savings directly associated with the level of usage and demand that inspired the General Assembly to mandate implementation of smart meter programs, and it is fully consistent with standard cost allocation methods to impose the common costs of these programs in proportion to the benefits that will be derived from the incurrence of those costs.

E. <u>The OCA's Proposed Cost Allocation Method Should Be Adopted By the Commission</u>

The OCA submits that the ALJ's criticisms of the OCA's proposed cost allocation method are unfounded. The OCA approach is not theoretical or speculative. It is supported by substantial practical evidence in the instant record. It is grounded in and consistent with accepted cost of service allocation principles, and if the method appears to produce disproportionate results, it does so because it appropriately identifies the cause of the costs as the benefits to be received. Those benefits are tied to the level of usage and demand. The OCA submits that it has offered a method for the allocation of common costs in this proceeding that is consistent with cost of service principles, with the Commission's directive on cost allocation set forth in the Implementation Order and with the purposes and goals of Act 129. Accordingly, the OCA respectfully requests that the Commission reject the ALJ's conclusion and adopt the OCA's cost allocation method for use in calculating Duquesne's SMC.

OCA Exception No. 5: <u>The ALJ Erred In Adopting the OSBA's Proposal for Allocating Common Smart Meter Costs</u>

In the I.D., the ALJ rejected both Duquesne's and the OCA's proposals for the allocation of common costs. Instead, the ALJ adopted the OSBA's alternate approach which proposes to allocate common costs in proportion to the meter costs that are directly assigned to each group. I.D. at 19. In doing so, the ALJ stated that this method would "provide some relief to residential and small commercial customers in the single-phase meter rate class group without the dramatic increase in costs proposed by the OCA for small C&I customers in the poly-phase meter rate class group and is consistent with reasonable cost of service practices." Id. at 19-20.

In proposing its alternative, the OSBA argued:

> Rather than requiring a decision on whether common costs should be allocated on the basis of number of customers, on the basis of energy consumption, or on the basis of some hybrid of those two approaches, [OSBA witness Knecht's] alternative offers a simple solution, *i.e.*, let the common costs follow meter costs. Furthermore, as Mr. Knecht testified, this alternative would also be consistent with reasonable cost of service practices.

OSBA M.B. at 15.

The OCA submits that the ALJ erred in adopting the OSBA approach. The OCA disagrees that the OSBA method is consistent with reasonable cost of service practices. The OCA submits that the OSBA method fails to follow the principle of cost causation because it does not reach the ultimate cause of the smart-meter costs – the expectation that customers will benefit in the form of energy and demand savings as a result of smart meter deployment. By not basing the allocation of common costs on the distribution of expected benefits, OSBA's approach does not recognize a basic goal of Act 129 – energy and demand savings to customers – and fails to adhere to the directive in the Implementation Order that costs are to be allocated to the customer groups who derive the benefits from those costs.

The Commission should reject the OSBA's approach as well as the flawed cost allocation method proposed by the Company, and should adopt the allocation method advanced by the

OCA on the ground that it is the only method proposed that reaches the underlying cause of the costs in this case and allocates those costs accordingly.

## III. CONCLUSION

For the reasons set forth in these Exceptions, the OCA respectfully requests that the Commission reject the determinations of the ALJ in each of the following areas: cost of equity capital, equity capitalization ratio and allocation of common costs. In place of the ALJ's rulings, the OCA urges the Commission to: (1) adopt 10.1% as the equity return to use in calculating the SMC until the conclusion of Duquesne's next litigated base rate case or until the Commission concludes a generic proceeding in which it establishes a procedure for using the Quarterly Earnings Reports to set a proxy equity return for use in the SMC; (2) adopt 51% as the proxy common equity ratio to be used in calculating the SMC; and (3) adopt the OCA's proposal for allocating the common costs associated with smart meter deployment on the basis of energy and demand. The OCA also respectfully requests Commission clarification with regard to the rate base valuation to be used when making quarterly updates to the SMC.

Respectfully Submitted,

David T. Evrard

David T. Evrard
Assistant Consumer Advocate
PA Attorney I.D. # 33870
E-Mail: DEvrard@paoca.org
Tanya J. McCloskey
Senior Assistant Consumer Advocate
PA Attorney I.D. # 50044
E-Mail: TMcCloskey@paoca.org

Counsel for:
Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152
Dated: February 17, 2010
122657