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March 1, 2010

VIA HAND DELIVERY

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

RE: Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan; Docket No. M-2009-2123950

Dear Secretary McNulty:

Enclosed for filing with the Pennsylvania Public Utility Commission ("PUC" or "Commission") are the original and nine (9) copies of the Reply Exception of the Met-Ed Industrial Users Group ("MEIUG"), Penelec Industrial Customer Alliance ("PICA"), and Penn Power Users Group ("PPUG") in the above-referenced proceeding.

As indicated on the attached Certificate of Service, all parties to this proceeding are being duly served. Please date stamp the extra copy of this transmittal letter and Reply Exception and kindly return them to us for our filing purposes. Thank you.

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SECRETARY'S BUREAU

Very truly yours,

McNEES WALLACE & NURICK LLC

By
Carl J. Zwick

Counsel to Met-Ed Industrial Users Group, Penelec
Industrial Customer Alliance, and Penn Power Users Group

CJZ/sds
Enclosures
c: Administrative Law Judge Susan D. Colwell (via E-mail and Hand Delivery)
Cheryl Walker Davis, Director, Office of Special Assistants (via E-mail and Hand Delivery with diskette in Word format)
Certificate of Service

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan	:	Docket No. M-2009-2123950

REPLY EXCEPTION
OF THE MET-ED INDUSTRIAL USERS GROUP,
THE PENELEC INDUSTRIAL CUSTOMER ALLIANCE,
AND THE PENN POWER USERS GROUP

Air Liquide Industrial U.S. LP
American Refining Group Inc.
Appleton Papers Inc.
Cambridge-Lee Industries, LLC
Cargill Taylor Beef
Carpenter Technology Corporation
Dixie Consumer Products, LLC, Lehigh Valley
East Penn Manufacturing Company
Electralloy, a G.O. Carlson, Inc., Co.
Ellwood National Steel
Ellwood Quality Steels Company
Erie Forge & Steel, Inc.
Exide Technologies, Inc.
Farmers Pride, Inc.
Glen-Gery Corporation
Harley-Davidson Motor Company – York Division
Knouse Foods Cooperative, Inc.
Lehigh Hanson, Inc.
Leprino Foods Company
LWB Refractories
Pittsburgh Glass Works, L.L.C.
PPG Industries, Inc.
RH Sheppard Co., Inc. – Foundry Division
Sheetz, Inc.
Standard Steel
Sweet Street Desserts, Inc.
Team Ten, LLC – American Eagle Paper Mills
The Plastek Group, Inc.
The Procter & Gamble Paper Products Co.
Tray-Pak Corporation
U.S. Silica Company
Wegmans Food Markets, Inc.

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Dated: March 1, 2010

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I. INTRODUCTION

On October 15, 2008, Governor Rendell signed into law House Bill 2200, or Act 129 of 2008 ("Act 129" or "Act"). Among other things, Act 129 expands the Pennsylvania Public Utility Commission's ("PUC" or "Commission") oversight responsibilities and sets forth new requirements on Electric Distribution Companies ("EDCs")[1] for energy conservation, default service procurements, and the expansion of alternative energy sources.

On August 14, 2009, Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), and Pennsylvania Power Company ("Penn Power") (collectively, "FE"[2] or "Companies") submitted a Joint Petition for Approval of their Smart Meter Technology Procurement and Installation Plan ("Petition") in accordance with the requirements of Act 129. The Companies' Smart Meter Procurement and Installation Plan ("Smart Meter Plan" or "Plan") was attached to the Petition.

On September 22, 2009, the Met-Ed Industrial Users Group ("MEIUG"), the Penelec Industrial Customer Alliance ("PICA"), and the Penn Power Users Group ("PPUG") (collectively, "MEIUG et al."), filed a Joint Petition to Intervene in this proceeding to address issues of importance to their members.

On January 28, 2010, Administrative Law Judge ("ALJ") Susan D. Colwell issued an Initial Decision ("I.D.") in this proceeding.[3] MEIUG et al. fully support the ALJ's well-reasoned I.D. and, therefore, did not file Exceptions in this proceeding.

MEIUG et al. received Exceptions from FE, the Office of Consumer Advocate ("OCA"), the Office of Trial Staff ("OTS"), and the Pennsylvania Department of Environmental Protection

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[1] As articulated in the Act, only EDCs with at least 100,000 customers are required to submit energy efficiency and conservation programs. See 66 Pa. C.S. § 2806.1, et seq.

[2] Because all three Companies are owned by FirstEnergy Corp. ("FE"), for ease of reference, these Reply Exceptions will refer to all three Companies collectively as "FE."

[3] MEIUG et al. submitted both a Main Brief (hereinafter, "M.B.") and a Reply Brief (hereinafter, "R.B.").

("DEP"). MEIUG et al.'s Reply Exception responds specifically to OCA Exception No. 2, which excepts to the ALJ's decision regarding cost allocation. As discussed more fully herein, MEIUG et al. submit that none of the arguments presented by the OCA would require the Commission to deviate from the ALJ's appropriate finding that PUC precedent requires meter costs be allocated to customers as proposed by the Companies (i.e., on a cost-causation basis). Therefore, the arguments raised in the OCA's Exceptions, regarding the aforementioned cost allocation issues, do not negate the propriety of the Commission adopting the ALJ's well-reasoned I.D. For that reason, MEIUG et al. respectfully request that OCA Exception No. 2 be denied.

II. REPLY EXCEPTION

1. Reply to OCA Exception No. 2: The Administrative Law Judge Correctly Approved the Companies' Proposal To Allocate Smart Meter Plan Common Costs Based On The Number of Customers in Each Class.

The Companies' Plan consists of a planning stage and a deployment stage (i.e., the "Assessment Period" and the "Deployment Plan," respectively). During the two-year Assessment Period, the Companies will assess needs, identify potential benefits, and develop proposed approaches to technology and deployment. See Smart Meter Plan, pp. 5-8. At the end of the Assessment Period, the Companies will file a proposed Deployment Plan with the Commission to address the proposed approach, project costs/benefits, and cost recovery. Id. at 9-12.

For purposes of allocating and recovering costs, the Companies propose to divide customers into three rate class groups: Residential, Commercial, and Industrial. The costs for the smart meters incurred during the Deployment Plan would be directly assigned to each rate class group. All costs incurred before and during the Assessment Period, as well as Smart Meter Plan costs that are not directly assignable in the Deployment Plan, would be deemed common

costs and allocated among the three rate class groups based on the number of metered customers in each class. See id. at 9-10; FE M.B., p. 38; MEIUG et al. M.B., p. 5.

The ALJ appropriately found that the Companies' proposed cost allocation should be approved. The OCA, however, excepts to the ALJ's agreement with the Companies' reasonable and rational approach for assigning the common costs of the Smart Meter Plan based on the number of metered customers in each class. See generally OCA Exceptions, pp. 6-17. Rather, the OCA claims that the Companies should assign these costs to customers "on a demand and usage basis." Id. at 6. To support such an allocation approach, the OCA asserts that "[t]he costs here are incurred to forward the purposes of Act 129 to provide benefits to customers in energy price reduction and stability through energy and demand savings." Id. at 7. The OCA's proposed cost allocation approach, however, is unsubstantiated and would require the Companies to allocate costs based on a "value of service" approach (i.e., according to a customer's energy or demand consumption), even though no nexus exists between the cost to the Companies for the Smart Meter Plan and a customer's energy or demand consumption, particularly with respect to the non-direct costs of administering the smart meter communication network and other back office systems. See MEIUG et al. M.B., pp. 10-16; MEIUG et al. R.B., pp. 3-11.

Accordingly, the I.D. properly rejected the OCA's cost allocation proposal, ruling that "[b]y proposing that the Companies allocate their [Smart Meter Plan] costs on the basis of energy usage and demand, the OCA is ignoring long-standing principles of cost causation." I.D., p. 55. Because the OCA's Exceptions to do provide any substantive basis to support its argument, much less overturn the ALJ's well-reasoned I.D., the OCA's Exceptions must be rejected, and the ALJ's I.D. should be adopted with respect to the cost allocation issues.

A. The OCA Misunderstands the Applicable Legal Precedent and Offers No Reasonable Justification for Rejecting the Companies' Proposed Allocation of Common Costs.

The Companies propose to allocate common (i.e., non-direct) costs through traditional cost of service ratemaking principles. See MEIUG et al. M.B., pp. 7-8; MEIUG et al. R.B., p. 3. The ALJ's well-reasoned I.D. approves this proposal by recognizing that this process follows Commonwealth Court precedent, the terms of the Implementation Order, and traditional cost allocation principles for meter. I.D., p. 55. In excepting to the I.D., the OCA ignores the Commonwealth Court of Pennsylvania ("Commonwealth Court") precedent, misinterprets the PUC's Implementation Order,[4] and disregards traditional cost causation principles. For these reasons, the OCA's Exceptions regarding cost allocation issues should be denied.

As the ALJ correctly recognized in her I.D., the Companies' approach for allocating the common costs of the Smart Meter Plan is squarely within Pennsylvania's long-standing precedent for establishing rates based on a utility's cost of providing the service. Id. at 55-56; FE M.B., p. 38; Office of Small Business Advocate ("OSBA") M.B., p. 4; MEIUG et al. M.B., p. 7. For example, the Commonwealth Court has clearly held that a utility's cost of providing service must be the guiding principle – or "polestar" – in utility ratemaking. See MEIUG et al. M.B., pp. 8-9 (citing Lloyd v. Pa. Pub. Util. Comm'n, 904 A.2d 1010, 1020 (Pa. Commw. Ct. 2006)). The Commission has since applied the Court's directive in Lloyd by recognizing that, while other factors may be considered, cost of service should be the primary consideration for ratemaking purposes. See MEIUG et al. M.B., p. 9; see, e.g., Pa. Pub. Util. Comm'n v. PPL Elec. Utilities Corp., Docket No. 00049255, 2007 WL 2198189 *7-10 (Order entered Jul. 25, 2007) (PUC order

[4] On June 24, 2009, the Commission issued an Implementation Order that established the substantive standards and guidance for EDCs in preparing and submitting their smart meter technology procurement and installation plans. See Smart Meter Procurement and Installation, Docket No. M-2009-2092655 (Order entered June 24, 2009) ("Implementation Order").

citing Lloyd in support of settlement of distribution rate increase based on cost of service principles).

Conversely, the OCA's proposal, which would shift substantial common costs from the Residential class to the Commercial and Industrial ("C&I") classes based on alleged "benefits" that customers might receive from the Smart Meter Plan, represents an allocation based on "value of service" principles. See id. at 10-16; MEIUG et al. R.B., pp. 3-7. Such an allocation approach is contrary to the Commission's cost of service ratemaking requirements. Id.

In addition, the OCA has not provided any legal support for deviating from this long-standing precedent, except to cite Illinois Commerce Commission v. FERC, 576 F.3d 470, 476 (7th Cir. 2009) ("ICC"), which is an appeal of a Federal Energy Regulatory Commission ("FERC") order regarding the allocation of transmission network improvement and enhancement costs. See OCA Exceptions, p. 14-15.[5] Because ICC is not binding precedent in this case, as it was decided by a federal court that exercises no jurisdictional authority over the Commonwealth of Pennsylvania and addresses costs that are not similar to the smart meter costs at issue here, the OCA's argument with respect to this legal argument is moot. See ICC, 576 F.3d at 476; see also MEIUG et al. R.B., pp. 4-5.

The OCA also attempts to discount the I.D.'s reliance on Lloyd by arguing that Lloyd upheld the energy-based allocation of Sustainable Energy Fund ("SEF") program costs to all distribution ratepayers on the basis that all ratepayers benefited from SEF activities. See OCA Exceptions, p. 14, n. 7. The SEF costs referenced in Lloyd, however, were social programming costs that the Court determined provided a public benefit to all customers. Lloyd, 904 A.2d at

[5] The OCA also cites indirectly to a number of other irrelevant FERC cases before various federal courts exercising no jurisdiction over the Commonwealth of Pennsylvania and addressing matters wholly unrelated to the issues in this proceeding. Id.

1026-27. Unlike the SEF costs at issue in Lloyd, the common costs of the Smart Meter Plan do not provide a public, or societal, benefit to customers; rather, these common costs are required for the development and installation of smart meter infrastructure. These infrastructure costs are no different from the infrastructure costs that are addressed in every distribution base rate proceeding. Thus, the OCA's argument that Lloyd somehow supports its "value of service" ratemaking approach is misplaced and must be rejected by the Commission.

Furthermore, by attempting to assign non-direct costs to C&I customers based on "value of service" principles, the OCA misinterprets what the ALJ recognizes is the Commission's clear directive in the Implementation Order to assign such costs on reasonable cost of service principles. See generally MEIUG et al. M.B., pp. 9-16; MEIUG et al. R.B., p. 5; see also Implementation Order, p. 32. The Implementation Order specifically states that "[a]ny costs that can be clearly shown to benefit solely one specific class should be assigned wholly to that class." Implementation Order, p. 32 (emphasis added). The OCA, however, attempts to extend this language to convince the Commission that all costs, even those that provide benefit across multiple classes, should be assigned to all customers according to speculative and unknown "benefits." See OCA Exceptions, pp. 12-13. In making its argument, the OCA completely ignores the Implementation Order's clear mandate that "[t]hose costs that provide benefit across multiple classes should be allocated among the appropriate classes using reasonable cost of service practices." Implementation Order, p. 32 (emphasis added).

Moreover, the OCA's proposal completely ignores reasonable cost of service practices as required under the Implementation Order. As succinctly stated in the Companies' Main Brief:

> [The OCA's] proposal to allocate Assessment Period or "common" costs based on the anticipated "benefits" of smart meters to each class – which [the OCA] assumes will be proportional to demand and/or energy – does not comply with "reasonable cost of service practices." Contrary to [the OCA's] contention, [its] proposed allocation method is not supported by the principle that costs

> should be allocated based on the factors that caused such costs to be incurred. [The OCA] distorts this principle by asserting that the "cause" of smart meter costs is the intended "benefit" of "savings in electricity supply costs" to the extent that customers respond to the dynamic pricing options that smart meters will make possible. [The OCA's] analysis simply re-packages [its] "benefits" based allocation by looking behind the actual cost-causative factors that should govern cost allocation – the need to install and electronically interconnect smart meters and manage the data they will produce – which are a function of the number of customers.

FE M.B., p. 42; see also MEIUG et al. R.B., pp. 5-6.

Finally, by refuting the I.D.'s well-reasoned conclusion that the common costs of the Smart Meter Plan are "akin to traditional metering costs," the OCA obfuscates the Commission's consistent application of costs related to metering systems. As the Companies correctly noted in their Main Brief, common metering costs – which smart meter common costs are – have traditionally been assigned to customers based on the number of customers in each class, and not on any other basis, particularly not on an energy or demand basis as suggested by the OCA. See FE M.B., p. 43; MEIUG et al. R.B., p. 6.

As the Companies have noted, this allocation of smart metering common costs is firmly in keeping with the Commission's delineated cost of service principles. See id. Specifically, the Companies confirm that "the 'common' costs being allocated here vary with the number of customers and not with changes in either demand or energy. Hence, they should be allocated on a customer basis." Id. The Companies correctly determine, and the I.D. agrees, that customer costs vary with the number of customers in each class, and this allocation method comports with "'reasonable cost of service practices' because it is the same method that utilities, with the Commission's approval, have employed for many years to allocate metering, meter-related and customer accounting costs among customer classes." FE M.B. at 39; see also I.D., p. 55. Conversely, the OCA would have the Commission abandon this long-standing position, as well as the Commonwealth Court-supported precedent for cost of service rates, by requiring the

Companies to now assign Smart Meter Plan common costs on a basis that clearly has no legal support or justification.

The simple fact is that the cost of administering the Companies' Smart Meter Plan is determined by the size of the smart meter network and the management system needed to read and process meter data, which is in turn a function of the number of customers that participate in the Plan and require smart meter connection. See Met-Ed/Penelec/Penn Power Statement No. 3-R, Rebuttal Testimony of Raymond I. Parrish (hereinafter, "FE St. 3-R"), p. 4. In other words, the Companies are going to incur the same amount of costs associated with the Smart Meter Plan regardless of the amount of kWhs and/or peak kW used by their customers. See FE M.B., p. 42; MEIUG et al. M.B., pp. 9-10. Thus, these costs are not connected to customer usage, but instead are incurred because of the existence of those customers on the Companies' system, regardless of their consumption and/or demands. Id. In this instance, the OCA has not proposed any legal precedent that would allow the Commission to deviate from such traditional ratemaking principles, much less allow for such divergence specifically for the Companies' Smart Meter Plan. Accordingly, the ALJ was correct in rejecting the OCA's argument on this point.

Based upon the aforementioned arguments, legal precedent supports the Companies' proposal to allocate common costs based upon traditional cost of service ratemaking principles as traditionally applied to meter costs. Moreover, the ALJ recognized this principle by specifically approving the Companies' proposal, which was also supported by the OSBA and MEIUG et al. Because the OCA has failed to provide any substantive legal precedent that would allow for the rejection of the Companies' proposal or the ALJ's findings, the OCA's Exception must be dismissed.

B. The OCA's Proposal to Assign Costs to Customer Classes on a "Value of Service" Basis Is Inappropriate, Unreasonable, and Unsubstantiated.

In addition to the fact that the OCA has provided no valid legal justification for its proposal to require the Companies to assign common costs on an energy and demand basis through a "value of service" ratemaking analysis, the OCA's argument is incurably flawed, as the OCA has not provided any basis for which the "value of service" proposal can be applied for ratemaking purposes. See generally MEIUG et al. M.B., pp. 7-16; MEIUG et al. R.B., pp. 7-11. Primarily, the OCA fails to provide reasonable support to substantiate the alleged energy and demand "benefits" that will purportedly result from the Smart Meter Plan and falls short in explaining how C&I customers will experience these supposed "benefits" to a greater degree than Residential customers. MEIUG et al. R.B., p. 7. In short, and as recognized by the ALJ in the I.D., the OCA provides no factual basis for its attempt to shift a large portion of non-direct, common costs from the Residential class to the Large C&I class. Id.; I.D., p. 55.

In its Exceptions, the OCA attempts to disguise its "value of service" ratemaking proposal as a cost of service approach by claiming that the common costs of the Smart Meter Plan are derived from the "benefits" that each class will receive and that these "benefits" are somehow related to energy and demand reductions. See generally OCA Exceptions, pp. 7-17. To support this "value of service" cost allocation proposal, the OCA concludes that the "benefits" realized by all customer groups "will accrue . . . based on those customers' total energy usage and the demand they place on the system." Id. at 7-8. The OCA, however, fails to provide any reasonable support for this categorical conclusion.

Even assuming, arguendo, that "value of service" is a legitimate method for establishing rates in this proceeding, the OCA fails to either accurately depict the actual benefits of the Smart Meter Plan or to demonstrate how C&I customers – and, in particular, the Large C&I customers – will realize these alleged "benefits." See MEIUG et al. R.B., p. 8. Perhaps because such

quantification is purely speculative, the OCA suggests that the "benefits" of the Smart Meter Plan are related to energy and demand savings and that these "benefits" are simply equivalent to the amount of energy and demand that each class of customers consume. See OCA Exceptions, pp. 8-12.

Specifically, the OCA posits that, since Residential customers are responsible for only 31.6% to 39.4% of the Companies' energy usage, these customers should pay an approximately equal percentage of the common costs of the Smart Meter Plan, presumably because these customers will also receive a similar percentage of the energy and demand "benefits" of the Plan. See id. at 12. By that same token, the OCA suggests that, because Large C&I customers are purportedly responsible for 27% to 34.6% of the Companies' energy usage, these customers should pay an approximately equal percentage of the common costs of the Smart Meter Plan. Id. The OCA, however, has neither identified nor quantified precisely what these energy and demand "benefits" might be and provides absolutely no credible evidentiary support for this broad conclusion. See MEIUG et al. R.B., p. 9. In fact, the OCA does not even suggest a reasonable causal link between these phantom "benefits" and the energy and demand requirements of the Companies' various customers. Id.

In addition, the OCA's proposed methodology results in nothing more than a subsidization of the Residential customer class by the Companies' other customers. Under the OCA's proposal, the Large C&I customers' allocation would increase by 8,500% on Met-Ed's system, 6,600% on Penelec's system, and 22,000% on Penn Power's system. See OSBA M.B., p. 11. Such a shift in costs would result in Large C&I customers subsidizing significant portions of common costs that are more appropriately allocated to the Residential class, as the Residential class is the reason for which the majority of these costs are being incurred. See MEIUG et al. R.B., p. 9.

Moreover, the OCA fails to prove that the purported benefits upon which this inappropriate methodology would be based even exist, regardless of whether they could be quantified. Id. The OCA is correct that the purpose of the Companies' new investment in smart meters is "not simply for the purpose of counting kilowatt hours and billing customers." OCA Exceptions, p. 7. Contrary to the OCA's conclusion, however, the actual purpose of Act 129's requirement for smart meter procurement and installation is to provide customers with "access to and use of price and consumption information," as well as the ability to participate in dynamic pricing programs. See MEIUG et al. M.B., pp. 15-16 (quoting 66 Pa. C.S. § 2807(g)); see also MEIUG et al. R.B., p. 9. Because the installation of an individual smart meter and the administration of the smart meter network to facilitate the meter cannot produce a single kW or kWh reduction absent some further step on the part of the customer, access to consumption information and dynamic pricing mechanisms are the only concrete customer benefits that will proceed directly from the Companies' Smart Meter Plan. See generally MEIUG et al. M.B, pp. 10-16. As such, any energy, demand, or price reduction that customers will see is purely ancillary to customers' participation in the programs that would directly provide such reductions. See MEIUG et al. R.B., p. 10.

Furthermore, the aforementioned benefits of the Companies' Smart Meter Plan (e.g., access to information) are accurately captured in the design and construction of the meters themselves – the costs of which are already directly assigned by the Companies to each customer that elects to install a smart meter. MEIUG et al. M.B, p. 12. Simply put, there is absolutely no direct causal connection between: (1) energy or demand savings; and (2) the procurement and installation of smart meters, or the administration of the smart meter system. See id. Moreover, the OCA has failed to provide any evidence to refute the solid position shared by the Companies, MEIUG et al., and the OSBA that the common costs of the Smart Meter Plan are not "connected

to customer usage, but instead are incurred because of the existence of those customers on the Companies' system, regardless of their consumption and/or demands." Id.; see also FE M.B., pp. 38-43; OSBA M.B., pp. 13-16.

As appropriately recognized by the ALJ in the I.D., the common costs at issue herein "will be incurred without regard to energy consumption or customer demand." I.D., p. 55. Nothing in the OCA's Exceptions negates this finding. Rather, the OCA's proposed "value of service" methodology is inappropriate and inapplicable to this proceeding. In addition, even assuming, arguendo, that such a methodology could be used, the OCA has failed to provide any quantification of the energy and demand "benefits" that would purportedly result from this rate allocation. Accordingly, OCA Exception No. 2 must be denied.

III. CONCLUSION

WHEREFORE, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, and the Penn Power Users Group respectfully request that the Pennsylvania Public Utility Commission deny the aforementioned Exception No. 2 of the OCA and adopt the well-reasoned and thoughtful Initial Decision of Administrative Law Judge Colwell with respect to the Companies' approach to Smart Meter Plan cost allocation.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By _____

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Counsel to the Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, and Penn Power Users Group

Dated: March 1, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the participants listed below in accordance with the requirements of Section 1.54 (relating to service by a participant).

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Carl J. Zwick

Dated this 1st day of March, 2010, in Harrisburg, Pennsylvania.