Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921
Tel: 215.963.5000
Fax: 215.963.5001
www.morganlewis.com

Morgan Lewis
COUNSELORS AT LAW

Anthony C. DeCusatis
215.963.5034
adecusatis@MorganLewis.com

RECEIVED
MAR 1 2010
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

March 1, 2010

VIA FEDERAL EXPRESS

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
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 are the original and nine (9) copies of the **Replies Of Metropolitan Edison Company, Pennsylvania Electric Company And Pennsylvania Power Company To The Exceptions Of The Office Of Trial Staff, The Office Of Consumer Advocate And The Pennsylvania Department Of Environmental Resources** in the above-referenced proceeding. Also enclosed is a disk containing the Replies in a searchable PDF format.

Copies of the Replies To Exceptions have been served upon Administrative Law Judge Colwell and all parties/intervenors in accordance with the attached Certificate of Service. An additional copy of this letter and the Replies To Exceptions are enclosed, which we request that you date-stamp and return to us in the stamped, self-addressed envelope provided.

Very truly yours,

Anthony C. DeCusatis

Anthony C. DeCusatis

Enclosures

c: 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

REPLIES OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY AND PENNSYLVANIA POWER COMPANY TO THE EXCEPTIONS OF THE OFFICE OF TRIAL STAFF, THE OFFICE OF CONSUMER ADVOCATE AND THE PENNSYLVANIA DEPARTMENT OF ENVIRONMENTAL RESOURCES

To The Initial Decision Of
Administrative Law Judge Susan D. Colwell

RECEIVED

MAR 1 2010

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Kathy J. Kolich, Esquire
Attorney No. 92203
FirstEnergy Service Company
76 South Main Street
Akron, OH 44308

Bradley A. Bingaman, Esquire
Attorney No. 90443
FirstEnergy Service Company
2800 Pottsville Pike
P.O. Box 16001
Reading, PA 19612-6001

Thomas P. Gadsden, Esquire
Attorney No. 28478
Anthony C. DeCusatis, Esquire
Attorney No. 25700
Catherine G. Vasudevan, Esquire
Attorney No. 210254
Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921

Counsel for:
Metropolitan Edison Company
Pennsylvania Electric Company
Pennsylvania Power Company

March 1, 2010

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

COURT CASES

COMMISSION CASES

STATUTES

I. INTRODUCTION

On January 28, 2010, Administrative Law Judge Susan D. Colwell (the "ALJ") issued an Initial Decision approving the Smart Meter Technology Procurement and Installation Plan ("Smart Meter Plan" or "Plan") filed by Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec") and Pennsylvania Power Company ("Penn Power") (collectively, the "Companies"), subject to her recommended revisions to three parts of the Plan.[1] On February 17, 2010, the Companies filed limited Exceptions addressed to the ALJ's recommended revisions to their Plan.

Also on February 17, 2010, Exceptions to the Initial Decision were filed by the Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA") and the Pennsylvania Department of Environmental Protection ("DEP"). The Companies herewith reply to the Exceptions filed by the OTS, OCA and DEP. In so doing, the Companies will refrain from responding in detail to each and every objection raised by those parties. Rather, the Companies will focus on what they perceive to be the more significant errors and misstatements in the other parties' Exceptions. For additional background information and analysis, the Companies urge the Commission to also carefully review their Initial and Reply Briefs before the ALJ, which were filed on December 11 and 31, 2009, respectively.

[1] The ALJ did not accept the Companies' proposals concerning (1) interest on over and under-collections, (2) current recovery of Assessment Period costs, and (3) base-rate recognition of operating and capital cost savings. *See* Initial Decision, pp. 41-47.

II. ARGUMENT

A. Incorporating The Definition Of "Smart Meter Technology" In The Commission's Final Order (DEP Exc. 1)

In its Main Brief (p. 8) before the ALJ, DEP contended that the Companies' Smart Meter Plan did not state, with the degree of specificity that DEP desired, that the smart meters the Companies intend to deploy will have the capability to provide usage data "through a HAN [home area network] or similarly capable method of open protocols" as the Commission's Implementation Order[2] provides. To eliminate any confusion on this issue, the Companies, in their Reply Brief, confirmed that they will "provide smart meters that fully comply with the definition of smart meters set forth in Section 2807(g) of the Public Utility Code and the Implementation Order, including the capability to furnish data through 'a HAN or a similarly capable method of open protocols.' " Apparently, the Companies' affirmation that they will comply with the law is not sufficient for DEP, which asks that the Commission's final Order in this case "explicitly require [the Companies] to deploy smart meters that enable HAN devices or similarly capable method with open protocols" (DEP Exc., p. 6). What DEP requests, while unnecessary, is not otherwise objectionable.

B. Deployment Timeframe (DEP Exc. 2 and 3)

Under the currently projected timeline in the Companies' Smart Meter Plan: (1) network design and the installation of between 5,000 and 10,000 smart meters will be completed by the end of 2013; (2) infrastructure build-out and the installation of 60,000 smart meters will be completed by March 2016; and (3) full scale deployment will start in April 2017 and be completed by March 2022 (Joint Petition, ¶¶ 13-26). Consequently, the Companies estimate that

[2] *Smart Meter Procurement and Installation*, Docket No. M-2009-2092655 (June 24, 2009) ("Implementation Order").

their full scale deployment of smart meters will be completed **three years before** the end of the fifteen-year deployment period set forth in the Commission's Implementation Order (p. 15).[3] Based on the testimony of its witnesses,[4] the OCA concluded that the Companies' proposed use of the 30-month "grace period" is reasonable, satisfies the requirements of Section 2807(f) and conforms to the milestones identified in the Implementation Order (OCA Main Brief, p. 10).

DEP is the only party that has disagreed with the Companies' proposed use of the grace period to develop their Deployment Plan for Commission approval. Despite direct testimony by the Companies' witnesses explaining how they planned to use the grace period and by the OCA's witnesses supporting the Companies' proposal, DEP did not submit testimony or other evidence responding to either party. Consequently, the ALJ found that undisputed record evidence supports the conclusion that the Companies' proposed use of the grace period is reasonable and consistent with Act 129 and the terms of the Implementation Order (Initial Decision, pp. 19-23).

In the absence of evidence that might support its position, DEP, in its Exceptions, continues to assert that the Implementation Order requires the smart meter "network" to be installed and fully functional by the end of the grace period. DEP is wrong on two counts. First, it has misstated the legal effect of the Implementation Order, which cannot function as a pre-

3 Additionally, at the OCA's recommendation, the Companies agreed to consider, during the Assessment Period, whether it would be feasible and beneficial to deploy smart meters more rapidly than currently proposed in their Plan (Companies Initial Brief, p. 17).

4 OCA witness J. Richard Hornby testified that "it is reasonable for the Companies to use the Assessment Period to determine the most cost-effective approach for each of their particular service territories" (OCA St. 1, p. 6). Similarly, OCA witness Nancy Brockway testified that "[t]he Companies propose to make good use of the Commission-approved grace period . . ." and that "[t]he process outlined [by the Companies] is a reasonable approach to determining the specifications of metering and communications technologies, and minimizing costs for full metering deployment during this grace period" (OCA St. 2, pp. 3 and 7-8). *See* Companies Reply Brief, pp. 2-3.

determination of the reasonableness of any aspect of the Company's proposed Smart Meter Plan. Second, DEP has misinterpreted the milestones set forth in the Implementation Order.

As DEP concedes (Exc., p. 7 and Main Brief, pp. 9-10), although Section 2807(f) establishes a deadline for full deployment of smart meters (15 years), it does not establish any interim deadline for the installation of a smart meter "network." Additionally, and as DEP also acknowledges, the legislature could not possibly have intended that EDCs should "have the necessary infrastructure in place to support smart meters . . . upon passage of the law or shortly thereafter" because it would be unrealistic to expect EDCs to design, acquire and construct those facilities within that time frame. Accordingly, reviewing and approving EDCs' plans for meeting the 15-year statutory deadline are functions that lie within the sound discretion of the Commission.

To help fulfill its statutory duty to review and approve individual smart meter plans, the Commission issued the Implementation Order to provide guidance on the elements EDCs' plans should contain. However, in issuing that Order, the Commission did not adhere to the formalities required to adopt a "regulation" and, as a consequence, that Order does not have the "force of law" that attends a regulation. *See* Companies Reply Brief, pp. 5-6. Rather, the Implementation Order, in addition to specifying filing dates and procedural requirements, announced the policy the Commission anticipated applying when it adjudicated individual smart meter plans after they were submitted for its approval by each EDC. In short, it was fully understood that binding Commission action would occur only **after** an EDC submitted its smart meter plan and the Commission completed its "adjudication" with respect to that plan.

In its Exceptions (p. 8), DEP concedes, as it must, that the Companies' legal analysis is correct. Nonetheless, DEP offers a convoluted argument that asks the Commission, in effect, to afford DEP's interpretation of the Implementation Order the same binding effect as a formally adopted regulation. DEP's new line of argument creates a distinction without a difference and, therefore, should be rejected by the Commission for the same reasons DEP's initial and virtually identical argument was rejected by the ALJ. Simply stated, the Implementation Order did not establish pre-determined outcomes for how and when network infrastructure should be installed and, therefore, cannot lawfully foreclose the Commission from considering and approving the Companies' proposal to use the grace period to assess its needs and develop a detailed Deployment Plan as proposed in their Smart Meter Plan. *See* Companies Reply Brief, pp. 5-6.

Furthermore, DEP's contention that the Company's proposed use of the grace period is inconsistent with the Implementation Order is simply wrong. The Commission's delineation of what it expects EDCs to accomplish during the "grace period" is identical to what the Companies propose to do during the Assessment Period, as is evident by comparing the relevant portion of the Implementation Order and the direct testimony of the Companies' witness, Mr. John Paganie, who described the Companies' Plan:

> Therefore, the Commission has established a period of up to 30 months for each EDC to assess its needs, select technology, secure vendors, train personnel, install and test support equipment and establish a detailed meter deployment schedule consistent with the statutory requirements.

Implementation Order, p. 9.

> During this grace period, the Companies will assess their needs, select the necessary technology, secure vendors, train personnel, install and test support equipment and establish a detailed meter deployment schedule consistent with the statutory requirements . . .

Companies' St. 1, p. 6.

DEP also contends that the timeline for build-out of network facilities proposed in the Companies' Smart Meter Plan will make it impossible for the Companies to provide functional smart meters to customers that request them and in "new construction" (DEP Exc., p. 7). That is simply not the case, since the Companies will provide alternative means, before full infrastructure build-out, to supply functioning smart meters to requesting customers and in new construction, as they explained in their Reply Brief (pp. 7-8).

Finally, as previously explained, the Companies' Smart Meter Plan currently projects that full scale deployment of smart meters will be completed three years before the end of the fifteen-year deployment period set forth in the Commission's Implementation Order. Nonetheless, DEP contends that full deployment should occur two years earlier than the Companies' Plan currently projects (i.e., a ten rather than twelve-year deployment period) (DEP Exc., pp. 11-12). There is no evidentiary support for DEP's proposal, and it should be rejected.

C. "Mitigation" Of The "Impact" Of Smart Meter Deployment On "Vulnerable" Customers (OCA Exc. 1)

In its testimony and briefs before the ALJ, the OCA offered a general recommendation that the Commission require the Companies to take steps to "mitigate" the "impact" of Smart Meter deployment on "vulnerable" customers.[5] The ALJ rejected the OCA's recommendations because they were ill-defined and raised concerns about affordability that properly should be addressed in other proceedings, such as those involving EDCs' Universal Service programs, which tackle those issues directly (Initial Decision, pp. 29-30).

[5] Although the OCA left the term "vulnerable" undefined and somewhat open-ended, its witness, Ms. Brockway, suggested that this category would include "customers with disabilities, the elderly, and others who cannot afford to see bill increases" (OCA St. 2, p. 11).

In its Exceptions (pp. 3-4), the OCA reiterates its earlier position and argues that "mitigation" should be fostered by imposing three requirements: (1) that the Companies conduct "a granular analysis of load shapes and usage characteristics" of a "sample" of "vulnerable" customers; (2) that the Companies "keep the costs of deployment down as much as possible;" and (3) that smart meter costs be recovered "primarily on a volumetric basis rather than fixed basis."

As to the OCA's first proposed requirement, the Companies understand the importance of developing pertinent, focused information about **all** customers' needs and receptiveness to new rate designs. Accordingly, this is an area the Companies intend to pursue both during and after the Assessment Period. However, the Companies do not agree that they should commit now to specific formats for such analyses or pre-determine how "granular" those analyses should be. All parties that desire to do so will have the opportunity to weigh in on these issues once the plan is developed and before extensive deployment begins.

The OCA's second recommendation, that the Companies "keep the costs of deployment down" and maximize the potential benefits to "vulnerable" customers, mirrors the approach the Companies intend to pursue with respect to all customers and all aspects of their smart meter program. Specifically, the Companies intend to carefully study needs, costs, and benefits in order to select smart meter solutions that comply with the law and provide the maximum benefit at the lowest cost.

The OCA's third recommendation simply repeats its views on cost allocation and rate design issues, which are set forth in OCA Exception Nos. 2 and 3. The Companies respond directly to those points in Sections I and J, *infra*.

Finally, as the ALJ emphasized in rejecting the OCA's recommendations (Initial Decision, pp. 29-30), the Companies intend to provide low-income and other "vulnerable" customers well-focused information and other educational tools to make them aware of the ways smart meters can help them manage their electric bills. In this way, the Companies will assist such customers in recognizing and realizing the benefits of smart metering. With respect to the costs of the Smart Meter Plan, each of the Companies currently has a Customer Assistance Program in place to assist low-income customers. These programs, as well as federal LIHEAP assistance, will substantially mitigate the impact on low-income customers of any increases resulting from the Smart Meter Plan. *See* Companies Initial Brief, p. 22.

D. Smart Meter Technologies Charge Filing And Reconciliation Dates (OTS Exc. 1)

The Companies propose to recover their smart meter technology costs through a reconcilable adjustment clause (the Smart Meter Technologies Charge or "SMT-C") established under 66 Pa. C.S. § 1307. The principal elements of the SCT-C are set forth in the Companies' Initial Brief (pp. 22-23) and the Initial Decision (pp. 30-32), which include the following milestone dates for SMT-C filings after the initial SMT-C rates become effective:

January 31	End of 12-month SMT-C Reconciliation Year
March 1	Filing date for (1) the statement of reconciliation of SMT-C revenues and costs for the Reconciliation Year and (2) the SMT-C rates to become effective on April 1 and accompanying information.
April 1	Beginning of 12-month SMT-C Computational Year and effective date of the proposed SMT-C rates subject to the Commission's subsequent review of the Companies' reconciliation statements and public hearings thereon, as required by 66 Pa. C.S. § 1307(e), and subsequent audits, as provided in 66 Pa. C.S. § 1307(d).

The OTS proposed an alternative filing schedule under which (1) the Computation Year would be a calendar year; and (2) the Reconciliation Year would be the 12 months ending six months prior to the beginning of the Computation Year. Accordingly, the Reconciliation Year would end on June 30 but new rates under the SMT-C would not become effective until January 1 of the following year. Thus, the OTS' alternative would introduce a six-month delay (from June to January) in incorporating over or under-collections in the SMT-C calculation. As explained in the Companies' Initial Brief (pp. 31-32), that delay is unnecessary and, in fact, is four months longer than the interval between the reconciliation year and computation year for existing Section 1307 adjustment clauses. Moreover, the OTS' proposal, apparently, was based on its misunderstanding of the review process permitted under Section 1307(e). *See* Companies Initial Brief, p. 32. The ALJ rejected the OTS' proposal, finding that the Companies' recommended timeline is both reasonable and consistent with the requirements of Section 1307.

The OTS has taken exception to the ALJ's finding to the extent that the ALJ did not adopt OTS' proposal for a "uniform review schedule for all EDCs" based on a reconciliation year ending June 30. In so doing, the OTS has renewed arguments that it made in its briefs before the ALJ, which the ALJ carefully considered and properly rejected for the reasons set forth in detail in the Initial Decision (pp. 38-41) and the Companies Initial Brief (pp. 31-33).[6]

E. Quarterly Updating Of The SMT-C (OTS Exc. 2)

The ALJ also rejected the OTS' proposal that the Companies revise their SMT-C Riders to require the filing of quarterly updates (Initial Decision, p. 41).[7] The ALJ correctly determined that quarterly "updates" are neither necessary nor particularly useful. Neither Section 2807(f)(7)

6 The OTS' Exceptions do not discuss the aspect of its proposal that would have introduced a six-month delay between the Reconciliation Year and the Computation Year. Consequently, it appears that the OTS has reconsidered its position and determined not to pursue that issue.

7 As described in the testimony of OTS' witness: (1) each quarterly filing would have to be made ten days before the beginning of each calendar quarter; (2) any changes in SMT-C rates would become effective on the first day of the calendar quarter; and (3) each "update" would have to include "calculations [of] the upcoming quarter's projected SMT recoverable costs and rider revenues" as well as a new calculation of each Company's "return component" (OTS St. 1, p. 9).

nor the Commission's Implementation Order requires quarterly updates or quarterly adjustments under a Section 1307 smart meter cost recovery clause. The alleged basis for the OTS' recommendations (i.e., "minimizing the impact of potential projection errors" and adjusting for "unexpected delays or efficiencies") do not justify the added time, resources and costs that the Companies, other parties and the Commission would have to dedicate to filing and reviewing quarterly updates. To be sure, quarterly updates and adjustments may be appropriate where the costs being recovered under a Section 1307 clause are volatile or where it is necessary to send pricing signals to customers about the cost of electricity supply, as in the case of default service. However, significant variances in smart meter costs from quarter to quarter are not anticipated, particularly since smart meter costs will be incurred pursuant to a pre-approved Plan with clearly defined deployment milestones.

Moreover, as OTS acknowledges, the Companies' SMT-C Riders authorize interim adjustments to avoid or preempt material over or under-collection of recoverable costs (OTS Exc., p. 11). The OTS minimizes the significance of interim adjustments because it claims that the interim adjustment provision can only be invoked at the discretion of the Companies. In fact, any interested party could request that the Companies make an interim adjustment if one is needed. Additionally, the Companies have no interest in permitting excessive over or under-collections to accrue. To the contrary, they have substantial incentives to monitor the operation of the SMT-C and propose interim adjustments if any are warranted.

F. Cost Of Capital (OTS Exc. 3, 4 and 5)

Act 129 provides that EDCs may recover reasonable and prudent costs of providing smart meter technology to their customers (66 Pa. C.S. § 2807(f)(7)) and, as explained in the Implementation Order (p. 29), such costs include, among others, "capital expenditures and facilities that may be required to implement the smart meter plan, as well as depreciation, operating and maintenance expenses, *a return component based on the EDC's weighted cost of capital*, and taxes" (emphasis supplied).

Under the Companies' proposed SCT-C Rider, their "weighted cost of capital" would be determined by: (1) using the most recent calendar year's cost of long-term debt as reported to the Commission in the Companies' quarterly earnings report as of calendar-year end; and (2) employing the capital structure ratios (51% long-term debt and 49% common equity) and cost of equity (10.1%) adopted by the Commission in Met-Ed's and Penelec's last distribution base rate cases at Docket Nos. R-00061366 and R-00061367, respectively, until updated capital structure and equity cost rate findings are made in a future Met-Ed, Penelec or Penn Power base rate proceeding (Companies St. 3, pp. 8-9). *See* Companies Initial Brief, p. 24. The ALJ reviewed all elements of the Companies' proposal and found that "*[t]he Companies' plan for cost recovery is reasonable and prudent on its face*" (Initial Decision, p. 32) (Emphasis added).

The OTS is the only party that objects to the ALJ's finding. In its Exceptions, the OTS reiterates the recommendations of its witness concerning the capital structure ratios, cost rates of senior securities and common equity cost rate that should be used to calculate the "weighted cost of capital" for use in the Companies' SMT-C Rider. As explained below and in the Companies' Initial Brief (pp. 25-30), each of the OTS' recommendations is seriously flawed, is inconsistent with the dictates of Act 129 and, therefore, was properly rejected by the ALJ.

Capital Structure Ratios. OTS' recommendation concerning the appropriate capital structure ratios – like other elements of its cost of capital proposal – relies heavily upon the "Report on the Quarterly Earnings of Jurisdictional Utilities" that is prepared by the

Commission's Bureau of Fixed Utility Services ("FUS") and published on a quarterly basis.[8] For purposes of determining the "weighted average cost of capital" to be used in the Companies' SMT-C Rider, the OTS' witness proposed that the FUS expand its Quarterly Report to include a "representative capital structure" for electric utilities, using data from the same barometer group from which FUS computes an indicative equity cost rate range (OTS St. 1, p. 17). OTS contends that using a generic "representative capital structure" is appropriate because: (1) it matches OTS' proposal to impose a generic "representative cost of equity" (i.e., a point value selected from the range of values currently presented in the Quarterly Reports); and (2) OTS believes that all EDCs subject to Act 129's smart meter provisions should have their capital costs calculated on the basis of a "uniform" capital structure which will not "advantage or disadvantage any EDC or its ratepayers" (OTS Exc., p. 14). The OTS' proposal is defective in several respects.

First, the Quarterly Reports are not intended for use in the manner the OTS proposes. Significantly, neither the selection of barometer group companies nor the calculation of "market indicated common equity cost rate ranges" set forth in Appendix D to the reports has been subjected to the level of scrutiny (e.g., discovery, cross-examination, briefing) as to reasonableness and accuracy that would occur in a base rate proceeding.[9] Indeed, for that reason, among others, the Quarterly Reports contain the following explicit disclaimer:

8 In addition to summarizing authorized and achieved returns for electric, natural gas and water utilities, Attachment D to the Quarterly Report provides "market indicated common equity cost rate ranges" for each of the three utility types. In developing equity cost rate ranges for electric companies, the FUS performs various analyses using the Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") methods and data for a barometer group of six companies (Alliant Energy, Consolidated Edison, Northeast Utilities, NSTAR, Pepco Holdings and Southern Company). Thus, in its most recent report at the time the record closed in this case (Companies Exhibit RIP-4), the FUS derived an overall DCF value of 11.29%, an overall CAPM value of 6.34% and an indicated equity cost rate range of 7.44% - 10.19%.

9 In contrast, the capital structure ratios and common equity cost rate approved in the last Met-Ed/Penelec base rate cases, which the Companies propose to use, are the product of rigorous rate case review.

> This report does not represent the views of the Pennsylvania Public Utility Commission or of any individual Commissioner or Commissioners. Selection of the information contained in this report was based solely upon the judgment made by staff of the Bureau of Fixed Utility Services. The calculation of market-derived returns on equity and the presentation of utility earnings data and related adjustments represent only the Bureau's interpretation of available data, and the Bureau makes no recommendation with regard to the use of the data.

Therefore, the OTS overstates its case by characterizing the six-company barometer group reflected in the Quarterly Report as "a Commission established barometer group" (OTS Exc., p. 13). Clearly, it is not.

Second, there is no basis for concluding that the capital structure ratios of the individual members of the OTS-preferred FUS barometer group are any more "representative of the industry norm" (OTS Exc., p. 16) than those adopted in the last Met-Ed and Penelec rate cases. Among the individual companies in that barometer group, long-term debt ratios for 2009 range from 35% (Alliant Energy) to 59% (Northeast Utilities) (Companies Exhibit RIP-5) *See* Companies Initial Brief, p. 26. Given that disparity among the companies in the FUS barometer group, the Companies' proposed 51% long-term debt ratio is clearly reasonable.

Third, there is no merit to OTS' contention that the Commission should impose a "uniform" capital structure on all EDCs (OTS Exc., p. 16). As explained by the Companies' witness (Companies St. 3-R, p. 9), each EDC is unique and each has approached the smart meter procurement and installation process in its own way. Some (e.g., West Penn Power Company) did not invest heavily in automatic meter reading equipment in the past, while others (e.g., PPL Electric Utilities Corporation) believe that their existing systems, for the most part, satisfy Act 129's smart meter requirements. In short, each EDC faces different challenges in terms of needed capital investment and/or operational improvements. Consequently, there is no rational basis for the OTS' attempt to impose "uniform" capital cost determinants on all such EDCs.

Fourth, and finally, the Commission's Implementation Order makes it clear that the appropriate return component must be based on "**the EDC's** weighted cost of capital," not some purported industry average. By attributing to each EDC the same generic "representative capital structure," the OTS would ensure that some companies under-recover their capital costs while other companies over-recover theirs.[10]

Cost Rates Of Senior Securities. The Companies and the OTS agree that the cost rates of long-term debt and preferred stock should be derived from the Companies' quarterly earnings reports filed with the Commission. The principal difference between the parties is that the Companies would update and adjust their SMT-Cs annually, while OTS recommends quarterly updating. For the reasons discussed in Section E, *supra*, the Commission should approve the Companies' annual adjustment proposal. Additionally, neither the frequency nor the magnitude of changes in the weighted average cost rate of senior securities is likely to produce any material impact on the Companies' overall cost of capital on a quarterly basis.

Common Equity Cost Rate. The differences between the Companies and the OTS regarding the cost of common equity are essentially the same as those that surfaced in their disagreement over the appropriate capital structure ratios to be utilized in calculating the cost of capital for the SMT-C Rider. The Companies would use Company-specific data -- in this instance, the Commission's most recent equity cost rate finding for Met-Ed and Penelec — while

10 The OTS also appears to contend that its position on cost recovery, and other issues, must be right because it presented "uniform recommendations" to the Commission in the various EDC smart meter proceedings. (OTS Exc., pp. 4-6). However, when it comes to the OTS' proposed "generic" capital structure ratios, ALJs have "uniformly" rejected the OTS arguments. *See* Initial Decision of Wayne L. Weismandel at Docket No. M-2009-2123945 (PPL) (p. 23) (January 21, 2010); Initial Decision of Robert P. Meehan at Docket No. M-2009-2123948 (Duquesne) (pp. 29-31) (January 21, 2010).

the OTS would opt for a generic, purportedly "representative" equity cost rate calculation. Contrary to the OTS' contentions, the Companies' currently authorized 10.1% equity return rate, which was determined after extensive investigation, is a better proxy for their current cost of equity than a "generic" figure derived from data for barometer group companies that may or may not share the same business risks as the Companies. For example, at least two members of the FUS electric barometer group (Alliant Energy and the Southern Company) operate in states that, unlike Pennsylvania, have not unbundled the generation function.

The OTS tries to defend the use of a "generic" equity return rate on the grounds that it is "an established Commission procedure that has been successfully applied to the Distribution System Improvement Charge ("DSIC") for the water industry" (OTS Exc., p. 21). However, that assertion is not entirely correct. In fact, in its Order approving the DSIC mechanism, the Commission directed water utilities to use the equity return rate approved in their last fully-litigated base rate proceeding and to resort to the "generic" FUS determination only where more than two years had passed since that rate decision was made. *See Petition of Pennsylvania-American Water Co.*, 1996 Pa. PUC LEXIS 182 (Order at Docket No. P-00961031 entered August 26, 1996). Unlike electric utilities, many water utilities file base rate cases on a two-year cycle, thus allowing them to go for extended periods without having to utilize the FUS "generic" return rate in their DSIC calculations.

Furthermore, and as evidenced by the data published in the Quarterly Reports, markedly different results can be produced depending upon various criteria, such as the barometer group companies selected, the choice of equity costing methods, and the determination of an appropriate DCF growth rate. For example, the FUS' overall CAPM finding (6.34%) is inexplicably, nearly 500 basis points lower than its overall DCF finding (11.29%) (Companies

Exhibit RIP-4, p. 12). Similarly, the FUS' current DCF estimate for electric companies is 90 basis points **higher** than for water companies, but its CAPM estimate for electric companies is 74 basis points **lower** than for water companies. *Id.* Stated simply, with well over a billion dollars of mandated smart meter investment at issue state-wide, the determination of a "generic" equity cost rate should not be made without all parties having an opportunity to be heard.

As noted previously, the Commission's Implementation Order makes it clear that each EDC is entitled to recover **its own capital costs** and, for that reason, the Companies' proposed use of a Met-Ed and Penelec-specific equity cost rate finding should be approved. However, if the Commission were to consider the use of a "generic" equity cost rate for smart meter cost recovery purposes, it should do so in the context of an industry-wide rulemaking proceeding where all interested parties can weigh in on the process to be employed in deriving the "generic" rate.

G. Interest On Over And Under-Collections (OTS Exc. 6)

The ALJ concluded that the imposition of interest on over or under-collections was not authorized and, for that reason, rejected both the Companies' and the OTS' positions. Both the Companies and the OTS have filed exceptions to this finding. In its Exceptions, the OTS, in addition to pointing out that interest on over and under-collections is permitted under Section 1307(e), continues to press its argument that interest should be paid only on net over-collections and that the rate of interest should be the maximum lending rate for residential mortgage loans specified by the Secretary of Banking under the Pennsylvania Loan Interest and Protection Law. For the reasons set forth in the Companies' Exceptions (pp. 5-6) and their Initial Brief (pp. 33-35), interest should accrue at the statutory rate (6%) on both net over and under-collections. There is no justification for the asymmetrical application of interest that the OTS recommends, which would deprive the Companies of the time value of money on net under-collections and, thereby, violate Act 129's directive for "full and current" recovery of smart meter costs.

The OTS further contends that interest should not accrue on net under-collections because the Companies' SMT-C rates will recover capital costs on the Companies' investments through the return component (OTS Exc., p. 23). This logic is flawed. The fact that the costs which are not being recovered include un-recovered capital costs is irrelevant to this issue. The return component built into the SMT-C does not recognize the time value of money associated with the shortfall in SMT-C revenues relative to SMT-C costs.[11] These shortfalls would need to be financed by the Companies until recouped in future SMT-C rates. Consequently, the recovery of interest on such net under-collections is both fair and equitable (*see* Companies St. 3-R, p. 11).

H. Current Recovery Of Administrative Start-Up Costs (OTS Exc. 7)

The OTS recommended that administrative start-up costs and Assessment Period costs be "capitalized" and recovered over the life of the smart meter technology to which such costs relate. The Companies proposed that both categories of costs be treated as expense items, which they properly are, and recovered on a current basis. The ALJ accepted the OTS' recommendation with respect to Assessment Period costs but agreed with the Companies that administrative start-up costs should be expensed (Initial Decision, p. 46). The Companies have excepted to the ALJ's decision regarding Assessment Period costs (Companies Exc., pp. 6-8). The OTS has excepted to the ALJ's decision regarding administrative start-up costs (OTS Exc., pp. 25-26). For the reasons set forth in the Companies' Exceptions and Initial Brief (pp. 35-36),

[11] As Judge Weismandel noted in his Initial Decision at Docket No. M-2009-2123945 (PPL): "Interest on over and under collections reflects the time value of carrying those amounts during the period, not a return on capital costs" (p. 25).

both administrative start-up costs and Assessment Period costs should be recovered on a current basis, as expense items.

I. Cost Allocation (OCA Exc. 2)

As explained in the Companies' Initial (pp. 38-42) and Reply (pp. 15-17) Briefs, their Smart Meter Plan "common" costs should be allocated among classes based on each class' number of customers because those costs are customer-related, i.e., they vary based on the number of customer accounts and not on the basis of either the energy a customer uses or its peak demand. Accordingly, the Companies' proposed customer-based allocation conforms to the Implementation Order's directive (p. 32) that costs not directly assigned should be allocated among customer classes "using reasonable cost of service practices." The OCA was the only party that opposed the Companies' proposed method of allocating common costs.

The ALJ accepted the Companies' position and found that "[b]ecause [smart meter common costs] will be incurred without regard to energy consumption or customer demand, and because the smart meter technology will be provided to all metered customers, any costs relating to the Companies' [Smart Meter Implementation Plan] that cannot be assigned to a specific customer class should be allocated based on the number of customers in each class, as the Companies propose" (Initial Decision, p. 55).

In its Exceptions to the Initial Decision, the OCA reiterates the position it advanced before the ALJ, namely, that: (1) Smart Meter Plan common costs should track the presumed "benefits" that each customer group might derive from the availability of smart meter technology; and (2) it should be assumed that such benefits will be realized in proportion to each class' relative peak demand and energy usage. The OCA offers three arguments to support its position: (1) smart meter common costs are qualitatively different from other forms of metering costs (OCA Exc., pp. 8-11); (2) a customer-based allocation places a larger proportion of common costs on the residential class than an energy-based allocation (OCA Exc., pp. 12-13); and (3) an energy-based or energy and demand-based allocation is consistent with "accepted ratemaking principles" that allegedly were affirmed in *Illinois Commerce Commission v. FERC*, 576 F.3d 470, 476 (7th Cir. 2009) (hereafter, "*ICC v. FERC*") (OCA Exc., pp. 13-17). None of the OCA's arguments is valid.

In its first argument, the OCA tries to re-package its proposed benefit-based allocation as a form of cost-based allocation in order to make it fit with the Implementation Order's prescription of "reasonable cost of service practices." Specifically, the OCA alleges that (1) the Legislature's purpose in enacting the smart meter provisions of Act 129 was to help customers realize "benefits" by "reducing and stabilizing the cost of energy" (e.g., OCA Exc., p. 10); (2) therefore, it should be assumed that such "benefits" are the underlying "cause" driving the Companies to incur smart meter common costs during the Assessment Period; and (3) viewed in this light, allocating smart meter common costs in proportion to anticipated "benefits" is not inconsistent with the Commission's directive to employ "reasonable cost of service practices" to allocate such costs.

At the outset, it is evident that the OCA's argument is based on rhetorical devices and lacks substance. Simply calling a benefits-based allocation a cost-based allocation does not make it so. Furthermore, if the OCA's application of the cost-causation principle were correct, then all utilities' existing, conventional metering would have to be reallocated on the basis of the presumed "benefits" customers obtain from having metered pricing rather than flat-rate pricing of their utility service. Public utility commissions, including this one, have long insisted that utilities incur the cost to conventionally meter their service – and impose commensurate metered rates instead of "flat" rates – because metered service encourages conservation, promotes wise and efficient use of utility service, and reduces overall costs. For example, in *Tiffany Assocs. v. Duquesne Light Co.*, Docket No. C-00981142, 1998 Pa. PUC LEXIS 206 (November 20, 1998), this Commission explicitly recognized the aforementioned causal relationship:

> We find that the interpretation of PURPA as it relates to metering requires the linkage of usage to cost of the utility service in order to promote conservation. The public interest in the conservation of energy and in keeping energy costs low outweighs the benefits resulting from master metering.

Of course, despite the Commission's recognition that all meter costs – not just smart meter costs – are incurred to promote the efficient use of utility service, it has consistently approved the allocation of such costs on a customer basis. (See the Companies' Initial Brief at pages 38-42, which discusses the long history of Commission decisions allocating meter-related costs on a customer basis.)

In its second argument, the OCA tries to support its position by pointing out that a customer-based allocation imposes a larger proportion of common costs on the residential class than an energy or demand/energy-based allocation (OCA Exc., pp. 12-13). However, the OCA simply compared the *results* of each allocation method and then assumed what it set out to prove, namely, that the common costs allocated to residential customers should be in proportion to their demand and energy. In short, the OCA would have its desired outcome dictate the propriety of the allocation method to be employed. That is an invalid argument. As the Implementation Order provides, "reasonable cost of service practices" should be employed in order to achieve a reasonable result. The Companies' proposed customer-based allocation does that, as the ALJ correctly determined.

In its third argument, the OCA contends that *ICC v. FERC* affirms its contention that allocating costs to customer classes in proportion to the assumed "benefits" each class might receive from those expenditures is "an accepted cost of service principle" (OCA Exc., pp. 13-17). The OCA is mistaken. Read in its entirety, *ICC v. FERC* does not support the OCA's position in this case.

In *ICC v. FERC*, the U.S. Court of Appeals for the Seventh Circuit reviewed the FERC's decision to require all the transmission owners in the PJM Interconnection LLC ("PJM") to contribute pro rata to the cost of financing new transmission lines of 500 kV or higher even though transmission owners in the Midwestern region of PJM would receive no "benefit" from the new facilities: "But as far as one can tell from the Commission's opinions in this case, the likely benefit to Commonwealth Edison from new 500 kV projects is zero." *Id.*

The holding of *ICC v. FERC* cannot be extended beyond the facts in that case, which involved a proposed assignment of responsibility for financing new transmission facilities among members of a large, multi-state, regional transmission operator ("RTO"). As such, the case raised the issue of whether any costs should be charged to transmission owners who were located "upstream" of the expected, future transmission projects and, therefore, would not realize any "benefit" from the new projects. As the Court explained, the cost assignment FERC approved was inconsistent with accepted ratemaking principles because (1) " '[A]ll approved rates [must] reflect to some degree the costs actually caused by the customer who must pay them.' (citations omitted)"; and (2) a customer cannot be deemed to have "caused" the "cost" of new facilities if those facilities will not provide service to that customer. *Id.* at 476.

Contrary to the OCA's contentions, *ICC v. FERC* applies the accepted principle that a customer should not bear the cost of facilities that are not used to serve it. While the majority opinion expresses this idea in terms of the "benefit" new transmission projects might confer on existing transmission owners, it did not require the FERC to employ the kind of "benefits"-based allocation of costs that the OCA advocates in this proceeding. *See* 576 F.3d at 477.

Obviously, the facts presented here are much different. Smart Meter Plan common costs are being incurred to serve **all** of the Companies' customers. Unlike the appellants in *ICC v. FERC*, the OCA cannot contend that the facilities represented by smart meter common costs will not be used to furnish service to residential customers. Clearly, they will. And, as such, the costs are properly allocated among customer classes in accordance with accepted "cost of service practices," which dictate a customer-based allocation. *See* Companies Initial Brief, pp. 38-42.

J. Rate Design (OCA Exc. 3)

The OCA takes exception to the Initial Decision because the ALJ did not accept the OCA's proposal to recover smart meter common costs in the energy charge (or energy and, as applicable, demand charges) of each rate schedule (OCA Exc., pp. 17-19). This exception is, essentially, an extension of the OCA's argument that smart meter common costs should be allocated on the basis of energy or energy and demand since "reasonable cost of service practices" dictate that costs should recovered from each customer within a class on the same basis those costs are allocated to each class. *See* Companies Initial (p. 41) and Reply (pp. 18-19) Briefs.

The OCA also contends (OCA Exc., p. 17) that recovering smart meter common costs in the customer charge is not permitted because (1) only "basic" customer costs may be included in the customer charge; and (2) allegedly, the Commission's holdings in *Pa. P.U.C. v. West Penn Power Co.*, 69 PUR4th 470, 521 (1985) and *Pa. P.U.C. v. West Penn Power Co.*, 1994 Pa. PUC LEXIS 144, 154 (1994) restrict "basic" customer costs to the costs for "the meter and service drop, meter reading and billings." First, smart meter common costs would reasonably fit within the category or "meter reading" costs and, therefore, constitute "basic" customer costs even under the restrictive definition the OCA advocates. Moreover, in later cases, the Commission made clear that "basic" customer costs include more than just the categories listed in the OCA's Exceptions. *See Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 239 PUR4th 218, 2004 Pa. PUC LEXIS 39 *97 (August 5, 2004) (Approving customer charges derived from a "basic" customer cost analysis that included the cost of "new technology" including the "costs of computers and other facilities needed to produce [meter reading] savings.")

III. CONCLUSION

For the foregoing reasons, the Commission should grant the Companies' Exceptions filed on February 17, 2010, deny the Exceptions of the OTS, OCA and DEP and adopt the Initial Decision with the modifications described in the Companies' Exceptions.

Respectfully submitted,

Thomas P. Gadsden, Esquire
Anthony C. DeCusatis, Esquire
Catherine G. Vasudevan, Esquire
Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921
Phone: (215) 963-5234
Fax: (215) 963-5001

Email: tgadsden@morganlewis.com

Kathy J. Kolich, Esquire
FirstEnergy Service Company
76 South Main Street
Akron, OH 44308
Phone: (330) 384-4580
Fax: (330) 384-3875
Email: kjkolich@firstenergycorp.com

Bradley A. Bingaman, Esquire
FirstEnergy Service Company
2800 Pottsville Pike
P.O. Box 16001
Reading, PA 19612-6001
Phone: (610) 921-6203
Fax: (610) 939-8655
Email: bbingaman@firstenergycorp.com

Counsel for:
Metropolitan Edison Company
Pennsylvania Electric Company
Pennsylvania Power Company

Dated: March 1, 2010

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

CERTIFICATE OF SERVICE

I hereby certify that I have served copies of **Replies Of Metropolitan Edison Company, Pennsylvania Electric Company And Pennsylvania Power Company To The Exceptions Of The Office Of Trial Staff, The Office Of Consumer Advocate And The Pennsylvania Department Of Environmental Resources** in the above-captioned matter on the dates and in the manner as set forth below, in accordance with the requirements of 52 Pa. Code § 1.54:

VIA ELECTRONIC AND OVERNIGHT MAIL

Honorable Susan D. Colwell
Office of Administrative Law Judge
Pennsylvania Public Utility Commission
Commonwealth Keystone Building, 2nd Floor
400 North Street
Harrisburg, PA 17120
scolwell@state.pa.us

RECEIVED
MAR 1 2010
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Tanya J. McCloskey
Senior Assistant Consumer Advocate
Aron J. Beatty
Candis A. Tunilo
Assistant Consumer Advocates
Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923
tmccloskey@paoca.org
abeatty@paoca.org
ctunilo@paoca.org
jhorner@paoca.org

Charles Daniel Shields
Senior Prosecutor
Carrie B. Wright
Prosecutor
Pennsylvania Public Utility Commission
Office of Trial Staff
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120
chshields@state.pa.us
carwright@state.pa.us

Daniel G. Asmus
Assistant Small Business Advocate
Office of Small Business Advocate
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, PA 17101
dasmus@state.pa.us

Charis Mincavage
Vasiliki Karandrikas
Carl J. Zwick
McNees Wallace & Nurick LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
cmincavage@mwn.com
vkarandrikas@mwn.com
czwick@mwn.com

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

Kurt E. Klapkowski
Assistant Counsel
Commonwealth of Pennsylvania
Department of Environmental Protection
RCSOB, 9th Floor
400 Market Street
Harrisburg, PA 17101-2301
kklapkowski@state.pa.us

Counsel for the Department of Environmental Protection

Harry S. Geller
John C. Gerhard
Julie George
Pennsylvania Utility Law Project
118 Locust Street
Harrisburg, PA 17101-1414
hgellerpulp@palegalaid.net
jgerhardpulp@palegalaid.net
jgeorgepulp@palegalaid.net

Counsel for the Pennsylvania Association of Community Organizations for Reform Now

Divesh Gupta
Senior Counsel
Constellation Energy
111 Market Place, Suite 500
Baltimore, MD 21202
divesh.gupta@constellation.com

Brian J. Knipe
Michael T. Killion
Buchanan Ingersoll & Rooney PC
17 North Second Street, 15th Floor
Harrisburg, PA 17101-1503
brian.knipe@bipc.com
michael.killion@bipc.com

Counsel for Constellation NewEnergy Inc. and Constellation Energy Commodities Group, Inc.

Anthony C DeCusatis

Anthony C. DeCusatis, Esquire
Attorney ID No. 25700
Morgan Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921
215.963.5034
adecusatis@morganlewis.com

Counsel For Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company

Dated: March 1, 2010

1123
03.02
1
205
FZ

00453-065515-0004 ACD

1701 Market Street
Philadelphia, PA 19103-2921

Morgan
COUNSELOR

TO: VIA FEDERAL EXPRESS

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

ORIGIN ID: REDA (215)963-5317
MAILROOM
MORGAN LEWIS & BOCKIUS LLP
1701 MARKET STREET

PHILADELPHIA, PA 19103
UNITED STATES US

SHIP DATE: 01MAR10
ACTWGT: 4.5 LB
CAD: 0684922/CAFE2434

BILL SENDER

TO JAMES J. MCNULTY
PA PUBLIC UTILITY COMMISSION
COMMONWEALTH KEYSTONE BLDG
400 NORTH STREET
HARRISBURG PA 17120

REF: 00705-001515-0004

FedEx
Express

E

TUE - 02MAR A

TRK# 0201 4222 5002 1173

PRIORITY OVERNIGHT

ZN MDTA

1712

PA-US

MDT

Part # 156148-434 NRIT V3 08-09