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May 31, 2012

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
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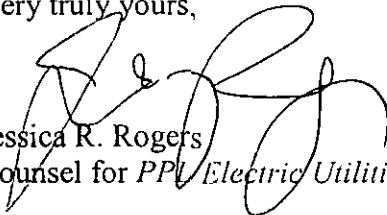
**RE: Comments of PPL Electric Utilities Corporation
Implementation of Act 11 of 2012 - Docket No. M-2012-2293611**

Dear Secretary Chiavetta:

Enclosed for filing are three (3) copies of the Comments of PPL Electric Utilities Corporation to the Commission's May 10, 2012 Tentative Implementation Order.

Should you have any questions regarding this filing, please direct them to me.

Very truly yours,


Jessica R. Rogers
Counsel for PPL Electric Utilities Corporation

JRR/kmg
Enclosures

cc: ra-Act11@pa.gov
David Screven
Louise Fink Smith
Erin Laudenslager

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Implementation of Act 11 of 2012

: Docket No. M-2012-2293611

**COMMENTS OF
PPL ELECTRIC UTILITIES CORPORATION**

I. INTRODUCTION

On February 14, 2012, Governor Corbett signed into law Act 11 of 2012 (“Act 11”), which amends Chapters 3, 13 and 33 of Title 66 of the Pennsylvania Consolidated Statutes (“Code”) to allow: (1) jurisdictional utilities to make rate case claims based on a fully projected future test year; (2) wastewater utilities to allocate a portion of their revenue requirement to the combined wastewater and water utility customer base; and (3) electric distribution companies (“EDCs”), natural gas distribution companies (“NGDCs”), and city natural gas distribution operations to establish a distribution system improvement charge (“DSIC”). On May 10, 2012, the Pennsylvania Public Utility Commission (“Commission”) issued a Tentative Implementation Order (“Order”) to establish procedures and guidelines to implement the ratemaking provisions of Act 11.

PPL Electric Utilities Corporation (“PPL Electric” or the “Company”) offers the following Comments to the Commission’s May 10, 2012 Order. In summary, PPL Electric:

- Believes that the Commission has the discretion to establish a DSIC rate based on a stipulated cost of common equity in a base rate proceeding;
- Encourages the Commission to revise the method currently used to calculate the cost of common equity in the Bureau of Technical Utility Services’ Quarterly Earnings Report for use in the DSIC;
- Agrees with the inclusion of depreciation and the exclusion of accumulated deferred income taxes associated with the eligible property in the calculation of the DSIC;

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- Supports allowing utilities to file their long-term implementation plans before January 1, 2013, but encourages the Commission to adopt a specific time limit for Commission review;
- Encourages the Commission to limit the plant and property considered in the long-term implementation plan to that property which is DSIC-eligible;
- Supports the Commission's decision to recognize in its review of the long-term implementation plans that certain utilities have been proactive in accelerating the upgrade of their facilities; and
- Requests clarification of certain provisions in the model tariff.

Each of these issues is discussed in more detail in Section III, below.

II. BACKGROUND

PPL Electric is a public utility and an EDC as defined in Sections 102 and 2803 of the Pennsylvania Public Utility Code, 66 Pa. C.S. §§ 102, 2803. PPL Electric furnishes electric distribution, transmission, and default service electric supply services to approximately 1.4 million customers throughout its certificated service territory, which includes all or portions of twenty-nine counties and encompasses approximately 10,000 square miles in eastern and central Pennsylvania.

On April 5, 2012, the Commission held a working group meeting for discussion and feedback from stakeholders regarding its implementation of Act 11. The purpose of the meeting was to address certain key implementation issues in advance of the issuance of the Order. PPL Electric was one of the participants in the working group. The Commission received input from stakeholders at the working group meeting, and the Order addresses and incorporates that input.

The Order proposes procedures and guidelines necessary to implement Act 11, including a DSIC mechanism for investor-owned electric and gas utilities, city natural gas distribution operations, and wastewater utilities. It also facilitates transition from Section 1307(g) water DSIC procedures to Act 11 DSIC procedures.

PPL Electric has been a long-time supporter of implementing a DSIC for electric utilities. PPL Electric acknowledges the Commission's efforts in developing Act 11 and its efforts to establish the rules necessary to implement the DSIC, and appreciates the opportunity to provide input to the Commission's deliberations in this matter.

III. COMMENTS

A. DSIC Rate Determination

1. Determining the Appropriate Return on Common Equity for the DSIC

Act 11 provides that the DSIC should be calculated based on "the equity return rate approved in the utility's most recent fully litigated base rate proceeding for which a final order was entered not more than two years prior to the effective date of the distribution system improvement charge." 66 Pa. C.S. Section 1357(b)(2). On page 15 of its Order, the Commission invites comment on whether the use of a stipulated return on equity from a settled rate case, which was agreed to or unopposed by all parties, would be consistent with Section 1357(b)(2). For the reasons set forth below, PPL Electric believes that the Commission can use a stipulated return on common equity in establishing the DSIC.

When the Commission is presented with a petition for settlement of a base rate proceeding, it does not simply approve (or reject) the settlement. Rather, the Commission reviews the record and makes an independent determination that the rates, and other terms and conditions in the settlement, are just and reasonable, and in the public interest. *See* 66 Pa. C.S. Section 1301. Similarly, when the Commission enters a final order in a base rate proceeding either after settlement or after full litigation, the rates established therein are "Commission-made rates" and can only be changed prospectively. *Cheltenham and Abington Sewerage Co. v. Pa. P.U.C.*, 344 Pa. 366, 370 (Pa. 1942), *West Penn Power Co. v. Pa. P.U.C.*, 174 Pa. Super 123,

131 (Pa. Super 1953). Commission-made rates can only be "implemented subsequent to an exhaustive evidentiary presentation of the company's expenses and their reasonableness, the fair value of the utility's property used and useful in the public service, and the return on that value." *Pa. Public Utility Comm'n v. Columbia Gas of Pa., Inc.*, Docket Nos. R-901873 et al., 1991 WL 338320 at *8 (Pa. P.U.C. Oct. 31, 1991). Commission-made rates can be established either through full litigation or by settlement/stipulation. Indeed, the Commission has specifically held that the Commission-made rate doctrine "applies to rates that result from settlement so long as the record is adequately developed to allow the Commission to independently review and make determinations concerning the Company's expenses and their reasonableness, the fair value of the utility's property used and useful in the public service, and the return on that value." *Id.* citing *Equitable Gas Co. v. Pa. Public Utility Comm'n*, 526 A.2d 823, 830 (Pa. Cmwlth. Ct. 1987).

For these reasons, PPL Electric believes that a stipulated return on common equity in a base rate proceeding can satisfy the "fully litigated" requirement in Section 1357. To reduce any uncertainty in this regard, base rate case settlements could include some variant of the following language:

The Joint Petitioners acknowledge and agree that this Settlement, if approved, shall have the same force and effect as if the Joint Petitioners had fully litigated this proceeding. This Settlement shall be considered to have the same effect as full litigation of this proceeding resulting in the establishment of rates that are Commission-made, just and reasonable rates.

This language and a stipulated cost of common equity would provide the Commission with the equivalent of a "fully litigated" determination of the cost of common equity upon the Commission's own investigation and subsequent approval of the settlement.

Based on the foregoing, PPL Electric believes that the approval of a stipulated cost of common equity in the settlement of a base rate proceeding is equivalent to a fully litigated proceeding. PPL Electric, therefore, believes that a return on common equity which is “stipulated as though fully litigated,” and which is subsequently approved by the Commission as a Commission-made rate, is within the scope of Section 1357(b)(2) and appropriate for use in the DSIC.

Act 11 also provides that where the Commission has not entered an order in a base rate case within two years prior to the implementation of a DSIC, “the equity return rate used in the calculation shall be the equity return rate calculated by the Commission in the most recent Quarterly Report on the Earnings of Jurisdictional Utilities released by the Commission.” Section 1357 (b)(3). PPL Electric recommends that the Commission substantially revise the current calculation of the return on common equity used in the Staff’s Quarterly Report before using it for the DSIC.

First, it is important to emphasize that the Staff’s Quarterly Reports, as currently constituted, are not “calculated by the Commission,” and are prepared only for informational purposes. They are not used to establish the rate of return on common equity rates for EDC ratemaking purposes. The Report itself contains a specific disclaimer which states as follows:

Disclaimer. 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 Technical 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.

As stated in the disclaimer, the Bureau makes no recommendation regarding the use of the return on common equity data, including use for ratemaking purposes.

This disclaimer is included for good reason. The Quarterly Report does not contain a comprehensive analysis of the cost of common equity and the calculations made therein are not fully consistent with the approach taken by the Commission when it determines the cost of common equity in a base rate proceeding. In several instances, underlying data is not provided and it is not possible to determine from the report how the cost of equity was determined. The Quarterly Report is not currently subject to any investigation or review by utilities or other parties to ensure that it is complete and accurate. While PPL Electric does not believe that the Quarterly Report should require a full Commission investigation, the Company encourages the Commission to modify the process so that there is more transparency with regard to how the return on common equity is calculated and the data used in that calculation.

PPL Electric would note that in the current calculation of the return on common equity for the Quarterly Report, there are certain underlying assumptions that should be revised in order to make the return on common equity more accurate. First, PPL Electric would encourage the Commission to modify the barometer group, because certain companies currently included in the barometer group are non-representative and, thus, negatively affect the DCF calculation. Second, the rate of return in the CAPM relies on short-term treasury bills and notes, which do not appropriately match up with the long-term nature of utility investments. Finally, other cost of equity methods should be included in the development of the quarterly equity return, to make it more reflective of the Commission's process of determining the return on common equity in base rate cases.

These concerns are reflected in the results reported in the Quarterly Report. First, the return on equity in the Quarterly Report is extremely volatile. For example, PPL Electric noted in its testimony and Main Brief for its Smart Meter Plan, Docket No. M-2009-2123945, that for return on equity for electric utilities in the Staff's Quarterly Reports for the five quarters between mid 2008 and late 2009 varied from 7.44% to 11.22%. Second, the return on equity developed in the Quarterly Reports varies significantly from the returns on common equity allowed by the Commission in litigated base rate cases. Third, in some instances, the indicated returns are simply too low. For example, the most recent Quarterly Report shows a low-end range cost of common equity of 3.95%, which is well below the current six-month average yield on Baa-rated public utility bonds of 5.05%. This is not a rational result and is at odds with relevant Commission precedent on this issue. For these reasons, the Commission should not use the current return on equity calculation in the Staff's Quarterly Report for DSIC purposes.

Rather, PPL Electric recommends that the Quarterly Report be revised to reflect a return on common equity calculation that is explicitly intended for use in the DSIC. This is consistent with Commission precedent. When the Commission implemented the DSIC for water utilities, the Commission's staff modified the return on equity calculation in the Quarterly Report in an effort to make the result more appropriate for use in the DSIC. A similar adjustment should be made with regard to the return on equity calculation for other utilities in the Quarterly Report. Further, in order to be fully consistent with the letter and the spirit of Section 1357(b)(2), the Commission should approve the return on common equity that is intended for DSIC use. This would ensure a return on common equity rate that is more reflective of those allowed in fully litigated rate cases and, thus, more appropriate for use in the DSIC mechanism.

2. Depreciation and Accumulated Deferred Income Tax

As described in the Commission's Order and reflected in the model tariff, the DSIC formula provides for a return on investment in DSIC-eligible property less accumulated depreciation on such property. Order at 16. PPL Electric supports this approach because it properly provides a return on net plant investment in DSIC-eligible property. PPL Electric also agrees that no adjustment for accumulated deferred income taxes ("ADIT") is appropriate. The calculation of an ADIT adjustment is complex and interrelated with broader tax calculations on non-DSIC-eligible property. The DSIC is intended to be a straightforward mechanism which is easy to calculate, easy to audit and which does not require a full rate case analysis. Deduction of ADIT would be inconsistent with that goal because it would complicate the DSIC and invite extensive review and litigation. There are many other ratemaking adjustments that could, in theory, be applied in calculating the DSIC. In PPL Electric's view, such an approach would be counterproductive and unnecessary because the DSIC contains an overall earnings cap, which effectively captures the revenue impact of all other adjustments and ensures that the DSIC does not result in unreasonable rates. *See* Section 1358(B)(3).

Finally, this approach is consistent with that taken by the Commission for water utility DSICs since 1996. The Commission has appropriately modeled the Act 11 DSIC after the water utility DSIC. The water utility DSIC does not recognize an adjustment for ADIT and neither should the broader DSIC implemented under Act 11.

B. Infrastructure and Asset Optimization Plan

Section 1352 of Act 11 requires that utilities submit a long-term implementation plan. In its Order, the Commission stated that in reviewing these plans, it will consider "all distribution plant, including its inventory, age, functionalities, reliability and performance." Order at 8. The

Commission provided that these plans may be filed before the January 1, 2013 filing trigger associated with the DSIC mechanism itself.

PPL Electric supports the Commission's decision to allow utilities to file their long-term implementation plans prior to January 1, 2013. PPL Electric provides three additional recommendations to make the administrative process more efficient and effective. First, PPL Electric encourages the Commission to adopt a time limit on its review of the implementation plans. The Company believes that 120 days should provide sufficient time for such a review process, particularly in light of the extensive detail that must be included in the initial filing of the plan. In order to facilitate an expedited review process, the Company also recommends that each utility be required to serve a copy of its plan on the statutory parties and all active parties in its most recent base rate proceeding. Second, PPL Electric believes that once the Commission has reviewed an implementation plan, those issues that were resolved in the implementation plan may not be reopened for additional review in the utility's subsequent DSIC filings.

Finally, PPL Electric notes that in discussing the long-term implementation plan on page 8 of its Order, and as quoted above, the Commission states that "all distribution plant" is subject to review. The remainder of the discussion on Section 1352 focuses on DSIC-eligible plant. PPL Electric believes that the Commission should limit the long-term implementation plan to a consideration of DSIC-eligible plant. Approximately one-third of PPL Electric's distribution plant is DSIC-eligible. Requiring the Company to include all of its distribution plant in the long-term implementation plan could pose a significant administrative burden on the Commission and parties participating in the Company's Act 11 proceeding. PPL Electric recommends focusing on DSIC-eligible plant because it is consistent with the statute and will provide the Commission

with an appropriate scope for making determinations on the DSIC without impacting the effectiveness or accuracy of the review.

PPL Electric also agrees with the Commission regarding its treatment of the accelerated infrastructure replacement component of the long-term implementation plan. In its Order the Commission stated that:

“We recognize that some utilities have already taken substantial steps recently to increase prudent capital investment to address their aging infrastructure; those utilities should indicate in their long-term plan how the DSIC will maintain or augment acceleration of infrastructure replacement and prudent capital investment.”

Order at 9. PPL Electric has increased its capital investments in recent years, and believes that utilities which have proactively undertaken infrastructure replacement should not be penalized for doing so. Between 2007 and 2011, the Company invested almost \$1.3 billion in the delivery system, and plans to invest approximately \$1.6 billion between 2012 and 2016. In 2011, alone, PPL Electric invested a total of \$326.6 million in distribution system improvements. The Company, therefore, supports the Commission’s decision to acknowledge proactive actions on the part of utility companies in its review of their long-term implementation plans.

C. DSIC Tariff Issues

The Commission provided, as an appendix to its Order, a model tariff. PPL Electric generally agrees with the Commission’s model tariff; however, the Company seeks two points of clarification. First, the model tariff states on page 7 that over collections will be refunded. Section 1358(d)(2), however, explicitly provides for reconciliation of both over and under collections. PPL Electric requests that the Commission specify in the model tariff that utilities also will be able to recover under collections.

Second, PPL Electric requests Commission clarification on the customer notice discussed in the model tariff on page 7. PPL Electric believes that the customer notice for the DSIC should be consistent with the customer notice provided for other quarterly rate updates. Specifically, the Company proposes that when the Commission approves initial implementation of the DSIC, PPL Electric will notify its customers through a bill insert. Thereafter, the Company proposes that it should be permitted to notify customers of the quarterly adjustments in its "Connect" brochure, which is included with customers' monthly bills. In addition, PPL Electric will include a separate line item on the customer's bill showing the DSIC charge. PPL Electric recommends this approach in order to be consistent with its current practice for other clauses, and to increase efficiency and reduce costs to customers. Therefore, the Company requests that the Commission modify the Customer Notice language found on page 7 of the model tariff to read as follows:

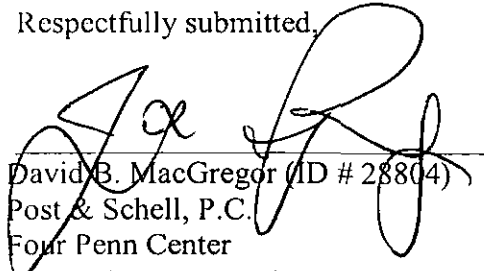
Customer Notice: Customers shall be notified of the initial implementation of the DSIC by bill insert at the first billing after implementation. For subsequent changes in the DSIC, appropriate information will be included on the first bill following any change. An explanatory statement to notify customers of subsequent changes will also be provided at the first billing.

PPL Electric believes that this language makes the obligations of the utility clear, and strikes the appropriate balance between providing customers with adequate notice and keeping administrative costs as low as possible.

IV. CONCLUSION

For the reasons set forth above, PPL Electric Utilities Corporation respectfully requests that the Commission consider these Comments when preparing its Final Implementation Order.

Respectfully submitted,



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