**BEFORE THE**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission : R-2012-2290597

:

Office of Consumer Advocate : C-2012-2300266

:

Office of Small Business Advocate : C-2012-2301063

:

PP&L Industrial Customer Alliance : C-2012-2306728

:

William Andrews : C-2012-2300402

:

Tracey Andrews : C-2012-2328596

:

Eric Joseph Epstein : C-2012-2313283

:

Dave A. Kenney : C-2012-2299539

:

Roberta A. Kurrell : C-2012-2304870

:

John G. Lucas : C-2012-2298593

:

Helen Schwika : C-2012-2299335

:

v. :

:

PPL Electric Utilities Corporation :

**RECOMMENDED DECISION**

Before

Susan D. Colwell

Administrative Law Judge

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I. INTRODUCTION

On March 30, 2012, PPL Electric Utilities Corporation (PPL Electric) filed for permission to increase rates by $104.6 million in this proceeding, and at the public meeting of May 24, 2012, the Commission suspended the filing for investigation. Under Section 1308 of the Public Utility Code, 66 Pa. C.S. § 1308, the Commission must act on this request on or before December 31, 2012.

Other parties have made alternative recommendations. The Office of Consumer Advocate (OCA) stated that the Company has only proven that it is entitled to an increase of $41,752,000 in overall revenues, or a 7.19% overall rate of return, with a return on equity of 9.0%. In addition, the OCA recommends: (1) rejection of the Company's management efficiency adder and its requested leverage adjustment; (2) adoption of the OCA cost of service study, which is not supported by any other party to this proceeding; (3) that the existing distribution customer charge be maintained at $8.75; (4) that the proposed competitive enhancement rider be limited to consumer education costs, and that it be structured on a class by class kWh charge basis; and (5) that the recommendations of Direct Energy by rejected.

The Commission's Bureau of I&E argues that the Company has failed to prove that it is entitled to the amount proposed, and further, that an $8.9 million decrease in revenue is warranted under the facts of the case. I&E charges that the Company's actions are structured to favor its own affiliates, for the ultimate benefit to its parent corporation.

The OSBA limits its argument to the revenue allocation and rate design portions of the case, weighing in favor of the methods used by the Company to evaluate cost of service and subsequent allocation of the proposed increases. OSBA recommends addressing the proposed Competitive Enhancement Rider in the Company's default service provider case.

Other parties participated and filed briefs for fewer issues: PPLICA and REG support the Company's position on cost allocation, and Granger and SEF support the Company's compromise position reached during the litigation. Dominion Retail and Direct Energy object to the Company's proposed increase in the discount rate for its purchase of receivables program and make alternate suggestions to counter it.

The Company points out in its Main Brief that the cost of common equity determination in this proceeding will determine the return on DSIC-eligible investments, and charges that "the investment community will be watching this case closely for guidance as to how the Commission plans to implement the DSIC and whether it will permit a reasonable return on DSIC-eligible investments." PPL Electric MB at 10.

For the reasons set forth in the Recommended Decision below, the Company should be granted an increase of $63,830,000, to be applied to the rate schedules as recommended by the Company, and the Competitive Enhancement Rider should be approved.

II. HISTORY OF THE PROCEEDING

On March 30, 2012, PPL Electric Utilities Corporation (PPL Electric or Company) filed Supplement No. 118 to Tariff Electric – Pa. PUC No. 201, containing proposed changes in rates, rules, and regulations calculated to produce approximately $104.6 million in additional annual revenues. This proposed rate change represents an average increase in the Company's distribution rates of approximately 13%, which equates to an average increase in total rates (distribution, transmission, and generation charges) of approximately 2.9%. Supplement No. 118 was proposed to take effect on June 1, 2012. The filing was suspended by Commission Order entered May 24, 2012.

Formal complaints against this proposed tariff have been filed by: the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), PP&L Industrial Customer Alliance (PPLICA), William Andrews, Tracey Andrews, Eric Joseph Epstein, Dave A. Kenney, Roberta Kurrell, Donald Leventry[[1]](#footnote-1), John G. Lucas, and Helen Schwika. Petitions to intervene were filed by the Commission on Economic Opportunity (CEO), Direct Energy Services LLC (Direct Energy), Dominion Retail, Inc. d/b/a Dominion Energy Solutions (DR), Granger Energy of Honey Brook LLC and Granger Energy of Morgantown LLC (collectively Granger or Granger Energy), the International Brotherhood of Electrical Workers, Local 1600 (IBEW), and the Sustainable Energy Fund (SEF). The Commission's Bureau of Investigation and Enforcement (I&E) filed a Notice of Appearance.

On May 17, 2012, a Notice was issued which scheduled the prehearing conference for Thursday, May 31, 2012. A prehearing conference order (First Prehearing Order) was also issued on May 17, 2012, which directed the litigating parties to file and serve their prehearing memos on or before Friday, May 25, 2012. Prehearing memos were filed by the following: PPL Electric, OCA, OSBA, I&E, PPLICA, CEO, SEF, IBEW, DR, Granger, Direct Energy, and Mr. Epstein.

The prehearing conference was held as scheduled on May 31, 2012. The following attended: John H. Isom, Jr., Esq., Paul E. Russell, Esq., and Christopher T. Wright, Esq., for PPL Electric; Darryl Lawrence, Esq., and Candis Tunilo, Esq., for OCA; Regina L. Matz, Esq., for I&E; Steven C. Gray, Esq., for OSBA; William E. Lehman, Esq., for DR; Joseph Vullo, Esq., for CEO; Adeolu Bakare, Esq., for PPLICA; Kenneth L. Mickens, Esq., for SEF; Scott J. Rubin, Esq., for IBEW; Carl Shultz, Esq., for Granger Energy and Direct Energy; and Mr. Epstein appeared pro se.

On June 1, 2012, a scheduling order was issued which adopted the schedule that the parties agreed to at the prehearing conference, with the addition of one more public input hearing held at the request of Representative Phyllis Mundy, 120th District. In recognition of the fact that the Company's service territory spans twenty-two counties in the Commonwealth, five public input hearings were scheduled and held to hear testimony of those persons who wished to provide evidence.

A few modifications were made to the Commission's discovery regulations according to the unopposed requests of the OCA and I&E. Of note, the OCA had requested that the scheduling order direct that parties providing prepared testimony either include the electronic workpapers, cited studies and other documents relied on or provide them within two business days of the testimony due date to all parties of record. The OCA reasons that the other parties routinely ask for these documents following the testimony's service through normal discovery channels, and that this method will streamline the process. No party objected, and the request was granted.

On June 11, 2012, the Company filed a Motion for a Protective Order. No party filed a responsive pleading, and the protective order was granted on July 3, 2012.

On June 18, 20, and 21, the public input hearings were held as scheduled.

On July 13, 2012, Richards Energy Group, Inc. (REG), filed a Petition to Intervene Out-of-Time, and by email, asked for an extension to file direct testimony. Also by email, the parties were given until July 20, 2012, to file a response to the petition to intervene. REG elected to not file direct testimony. No responsive pleading has been filed to the petition to intervene, and the intervention was granted by Order issued July 26, 2012.

The evidentiary hearings were held as scheduled. A hearing was held on October 11, 2012, to hear the testimony of Tracey Andrews, whose formal complaint was filed on May 1, 2012, but was not properly listed against this rate case until October 10, 2012. The record content is set forth in Appendix A, attached to this Recommended Decision, in addition to a transcript of **613** pages.

On August 29, 2012, the parties filed main briefs, and in addition, PPL Electric filed a Petition to Reopen the Record in order to provide updated information regarding the long-term debt issued on August 24, 2012. Following a reduction in the ten-day response period, during which no objections were received, on September 10, 2012, the record was reopened for the purpose of accepting the updated information.

On September 14, 2012, the parties filed reply briefs. The record closed upon their receipt, and the matter is now ripe for disposition.

III. SUMMARY OF PUBLIC INPUT HEARINGS

Five public input hearings were held over the course of a week in June. The following is a summary of the testimony given:

**1. Scranton State Office Building, Monday June 18, 2012, 2:00 pm**

Jim Bosso, employed in a janitorial capacity, testified that his financial advisor had recommended selling PPL Corporation stock. He testified further that this is not the time for a rate increase because of severe weather repercussions and a weak economy. Tr. 37-39.

Alex Sponza, self-employed as a car dealer and salesman, opined that he thought that the demand meter caused him to pay more than the residential rate, and because of the reduction in the consumption of electricity that the Company wants more money. People are having a hard time and do not need increases. Storm damage from 2011 should be paid from bills already collected. Tr. 39-41.

Mark Kasulaitis, employed by General Dynamics, testified that he doesn't believe that the increase is good for anyone but PPL, and that there is no choice in the transmission of electricity. Tr. 41-42.

Frances Page, employed in advertising by R.J. Palmer, testified that she has recently become involved in a citizens group concerned about the route for the North Pocono Reliability Project and asks that any portion of a rate increase to be used towards building that project be set aside. Tr. 42-44.

June Ejk, supervisor for Clifton Township, testified that she is concerned about the impact of the transmission project referred to by the prior speaker and the unfair burden placed on the customers by the additional rate increase. Tr. 45-46.

**2. Kings College, Burke Auditorium, Wilkes-Barre, Monday, June 18, 2012, 6:00 pm**

Omeed Firouzi for Representative Phyllis Mundy, appreciates the good service provided by PPL Electric to the Representative Mundy's constituents, but takes issue with the proposed rate increase. This is the fourth base rate case in under a decade and is aimed at the residential class. PPL Electric has received close to 300 million dollars in rate hikes over the past eight years alone. The return on equity sought here is 11.25%, which is extremely high in the present economy, and she expressed shock that it would be sought at a time when the incomes of her constituents and all Pennsylvanians are so strained by high prices, job losses, and losses in investment income. The Company and the PUC should be doing all they can to keep electric bills at a minimum, and a company serving basic human needs should not be seeking an 11.25% profit margin. The increase in almost completely residential, which means that the industrial and commercial classes will see a very slight difference in rates, and this is not an equitable manner in which to allocate the increase.

As the increase is proposed to affect the fixed monthly charge, customers will not be able to avoid the increase by conservation. She has been contacted by constituents who have been told numerous times to conserve in order to mitigate the effects of a rate increase. They are using less and less but paying more for it.

The present rate increase request is riddled with many issues that the PUC has the opportunity to fix. Tr. 65-70.

Frank Berbick, employed by Air Products & Chemicals, as well as self-employed in an electrical business, questioned where the money is going. He pointed out that the PPL vehicles are new, in contrast to the old vehicles that they used prior to the construction of the power plant. In addition, he questions why there is not a flat rate for transmission and distribution instead of a charge per kilowatt hour. Anything over 3 kW, which is roughly equal to two hairdryers, triggers the higher rate. He believes that the demand rates should raised to 10 or 15 kW.

In addition, in 1964 the National Electrical Manufacturers Association set standards and all equipment is manufactured for that voltage. Voltages coming into your house are higher, causing you to draw more kW than you use, which means that you're paying for more electricity than you need. The Company ought to be made to regulate their voltage closer to the actual nominal voltages. Tr. 70-73.

Joseph Marczak, owner of Sanitary Ice Manufacturing in Wilkes-Barre, relies on electricity to make ice. He asked what Act 129 was, and was told that it is legislation which imposes mandatory conservation programs on the electric utilities to reduce consumption. There is a fee placed on bills to pay for the programs. Mr. Marczak testified that he ended up paying himself if he took advantage of the programs. He stated that he had paid $15.98 on a recent bill so that he could ultimately get a rebate, and labeled it voodoo economics. In terms of demand charges, he is charged based on his highest use, which is not the normal usage. If something outside of his control makes the power to his plant dip, the equipment restart makes his charge go up, too.

He investigated how water heaters being proposed for energy conservation and discovered that a single unit can draw as much power as his whole building. Yet the residential customers aren't charged the demand charge while his use of high power for one 15-minute interval will increase his billing rate for the entire month. This high demand charge is killing industry. He believes that the demand charge should apply to residential classes as well.

He notes, too, that the price to compare never matches the price on his bill. He believes that when New York City draws extra power during heat waves, his own bill will increase because the market demands it. He notes that he has had to raise his own ice prices because of the increases. "Enough is enough."

He believes that the industrial consumers are balancing the residential load. He thanked the Commission for scheduling a public input hearing in his area, and noted that he opposed the proposed rate increase. Tr. 74-85.[[2]](#footnote-2)

Barbara Smith, lawyer and trustee of the John Nesbitt Reese and Sara Henry Reese Charitable Foundation, spoke on her own behalf to oppose any aspect of the proposed rate increase related in any way to the Northeast Pocono Reliability Transmission Line. It is not necessary to the Poconos and impacts private and public lands and water quality. Tr. 84-88.

Robert Shortz, not employed, testified that he pays the extra $5.00 per month charge for green energy, so he is not opposed to a little extra money for responsible electric generation. However, he believes that this is not the time for a rate increase. Peoples' income is down to 2003 levels, and a rate increase at this time is irresponsible. The Company is just reaching into our pockets when there is no ability to acquire more money right now. PPL's radio ads claiming that they are no longer in the generating business are belied by its nuclear plant, and this is disingenuous. Tr. 88-90.

**3. Northampton College, Gates Center, Bethlehem, Wednesday, June 20, 2012, 2:00 pm**

Jim Picot, formerly employed by a newspaper which employed 142 employees and now has 48. This type of rate increase amounts to public welfare. While he knows that PPL Corporation is technically a different corporation from PPL Electric Utilities Corporation, the first company has just bought another utility, and he wants to know where they are getting the $227 million for that purchase. This Company just keeps coming after customers, and where do they expect the customers to get more money? This is corporate welfare. They should be made to open their books. He questioned the decision to separate the companies, and he recommended eliminating the attorneys to save money. He also recommends cutting the $7 million per year executive's salary in half or getting rid of him. He indicated that there were utility poles just laying on the end of his road and not being used. In addition, he was offended that the commissioners, in their patronage jobs, did not attend the public input hearing. He wants the Company to cut its top brass before asking for more money. Tr. 108-114.

4**. Muhlenberg College, Seeger Union, Allentown, Wednesday, June 20, 2012, 6:00 pm**

No witnesses appeared at the appointed time for the public input hearing.

**5. Commonwealth Keystone Building, Hearing Room 1, Harrisburg, Thursday, June 21, 2012, 6:00 pm**

Geoffrey Lincoln, employed by the Commonwealth, recounted the history of PPL and electric competition and the rate increases which occurred in the last ten years, culminating in the question, where does this end? He recommends that the Company carry storm damage insurance, and recommends passing on some of the tree removal costs to property owners to reduce costs. He questioned smart grid maintenance costs and recommended funding large infrastructure improvements using bonds or stocks. Customers should have input into how and where their funds are being used. Smart meters should be paid over time as part of the electric bill by households that have the opportunity to use real-time pricing to save money, unlike the proposed rate increase which can't be avoided by conservation. He recommends that generators be required to pay for part of the smart grid since they will save money through the efficiencies by needing fewer new plants, and he recommends applying a portion of the cost of an electric car towards the smart grid.

The last point he made concerned net metering. He believes that the current net metering payment is not enough incentive to develop green energy like solar and wind by individuals. Decentralized power generators should foot some of the bill for smart grid and in return, the 110 percent net metering limits should be removed. He believes that there should be a change in strategic planning away from centralized power generation to a mix of centralized and decentralized power to serve the future needs of the community. Tr. 138-143.

Mary Strawbridge, retired, testified that this proposed increase would be a burden on the elderly and retired individuals on fixed incomes. Her own bill in the winter is around $600 per month. Her home, built in 1955, is an open design that cannot be closed off in parts. She testified that there are choices to be made in paying bills, and that sometimes a trip to the doctor must be put off because the copay is due, and a rise in any other bill may result in her not having the money for it. The low income people on fixed incomes need to be heard here, because they do not get raises and cannot receive promotions. Tr. 145-148.[[3]](#footnote-3)

Note that the Company reviewed the informal comments filed in the Secretary's Bureau and identified roughly a dozen which indicated concerns regarding payment of their electric bills. These individuals were not payment-troubled, and therefore, not eligible for OnTrack, but each has been sent a letter with a brochure describing PPL Electric's low-income programs. PPL Electric Stmt. 9-R at 27-28.

IV. DISCUSSION

**A. Description of the Company**

PPL Electric Utilities Corporation is a jurisdictional electrical distribution company (EDC) providing electric distribution service to approximately 1.4 million customers in all or portions of 29 counties in eastern and central Pennsylvania.

Under its present corporate structure, it is a wholly owned subsidiary of PPL Corporation, which also owns the generation formerly owned by the utility. Another subsidiary of PPL Corporation is PPL Services Corporation, which provides various administrative and general services to the utility, including legal services, human resources, auditing, and community affairs.

**B. Legal Standard**

Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301, provides: “every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly,

shall be just and reasonable, and in conformity with regulations or orders of the commission.” In deciding any general rate increase case brought under Section 1308(d) of the Code, 66 Pa.C.S.

§ 101 *et seq.*, certain general legal standards always apply.

The burden of proof to establish the justness and reasonableness of every element of the utility’s rate increase rests solely upon the public utility. 66 Pa. C.S. § 315(a). “It is well-established that the evidence adduced by a utility to meet this burden must be substantial.” *Lower Frederick Twp. v. Pa. Pub. Util. Comm’n*, 409 A.2d 505, 507 (Pa. Cmwlth. Ct.1980).

While the burden of proof remains with the public utility throughout the rate proceeding, where a party proposes an adjustment to a ratemaking claim of a utility, the proposing party bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *Pennsylvania Publ. Util. Comm’n v. Aqua Pennsylvania, Inc*., Docket No. R-00072711 (Commission Opinion and Order entered July 17, 2008). As stated in *Pa Publ. Util. Comm'n* *v*. *Philadelphia Gas Works*, Docket No. R-00061931 (Commission Opinion and Order entered September 28, 2007) at 12: “Section 315(a) of the Code, 66 Pa.C.S. § 315(a), applies since this is a proceeding on Commission Motion. However, after the utility establishes a prima facie case, the burden of going forward or the burden of persuasion shifts to the other parties to rebut the prima facie case.”

In addition, Section 523 of the Public Utility Code, 66 Pa.C.S. § 523, requires the Commission to “consider . . . the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates. . . .” In exchange for customers paying rates for service, which include the cost of utility plant in service and a rate of return, a public utility is obligated to provide safe, adequate and reasonable service. “[I]n exchange for the utility’s provision of safe, adequate and reasonable service, the ratepayers are obligated to pay rates which cover the cost of service which includes reasonable operation and maintenance expenses, depreciation, taxes and a fair rate of return for the utility’s investors . . . In return for providing safe and adequate service, the utility is entitled to recover, through rates, these enumerated costs.” *Pennsylvania Pub. Util. Comm’n v. Pennsylvania Gas & Water Co.,* 61 Pa. PUC 409, 415-16 (1986); 66 Pa.C.S. § 1501. Accordingly, the General Assembly has given the Commission discretionary authority to deny a proposed rate increase, in whole or in part, if the Commission finds “that the service rendered by the public utility is inadequate.” 66 Pa.C.S. § 526(a).

A public utility need not affirmatively defend every claim it has made in its filing, even those which no other party has questioned absent prior notice that such action is to be challenged. *Allegheny Center Assocs. v. Pa. Publ. Util. Comm’n.,* 131 Pa.Cmwlth. 352, 359, 570 A.2d 149, 153 (1990) (citation omitted). *See also, Pa. Publ. Util. Comm’n. v. Equitable Gas Co*., 73 Pa. P.U.C. 310, 359 – 360 (1990).

Additionally, the provisions of 66 Pa.C.S. §315(a) cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. The Legislature is not presumed to intend an absurd result in interpretation of its enactments[[4]](#footnote-4), the burden of proof must be on a party to a general rate increase case who proposes a rate increase beyond that sought by the utility.

The mere rejection of evidence contrary to that adduced by the public utility is not an impermissible shifting of the evidentiary burden. *United States Steel Corp. v. Pa. Publ. Util. Comm’n.*, 72 Pa. Cmwlth. 171, 456 A.2d 686 (1983).

When parties have been ordered to file briefs and fail to include all the issues they wish to have reviewed, the issues not briefed have been waived. *Jackson v. Kassab,* 2002 Pa.Super. 370, 812 A.2d 1233 (2002), *appeal denied*, *Jackson v. Kassab*, 573 Pa. 698, 825 A.2d 1261 (2003), *Brown v. PA Dep’t of Transportation,* 843 A.2d 429 (Pa.Cmwlth. Ct., 2004), *appeal denied*, 581 Pa. 681, 863 A.2d 1149 (2004).

The Commission is not required to consider expressly and at length each contention and authority brought forth by each party to the proceeding. *University of Pennsylvania v. Pennsylvania Pub. Util. Comm’n.*, 86 Pa. Cmwlth. 410, 485 A.2d 1217 (1984). “A voluminous record does not create, by its bulk alone, a multitude of real issues demanding individual attention . . . .” *Application of Midwestern Fidelity Corp.*, 26 Pa. Cmwlth. 211, 230 fn.6, 363 A.2d 892, 902, fn.6 (1976). Further, a Commission decision is adequate where, on each of the issues raised, the Commission was merely presented with a choice of actions, each fully developed in the record, and its choice on each issue amounted to an implicit acceptance of one party's thesis and rejection of the other party's contention. *Popowsky, et al. v. Pa. Publ. Util. Comm'n* , 550 Pa. 449, 706 A.2d 1197 (1997), 1997 Pa. LEXIS 2756.

The standard formula for determining a utility's base rate revenue requirement is:

RR = E + D + T + (RB x ROR)

RR: Revenue Requirement

E: Operating Expense

D: Depreciation Expense

T: Taxes

RB: Rate Base

ROR: Overall Rate of Return

I&E Stmt. 1 at 4-5; I&E MB at 75 fn 158.

The focus of a base rate case is to determine the correct values to insert into the formula above. After determining the correct revenue requirement, the appropriate allocation of that revenue among the rate classes will be determined.

**C.** **Rate base**

In analyzing a proposed general rate increase, the Commission determines a rate of return to be applied to a rate base measured by the aggregate value of all the utility’s property used and useful in the public service. The Commission determines a proper rate of return by calculating the utility’s capital structure and the cost of the different types of capital during the period in issue. The Commission is granted wide discretion, because of its administrative expertise, in determining the cost of capital. *Equitable Gas Co. v. Pennsylvania Pub. Util. Comm’n*., 45 Pa. Cmwlth. 610, 405 A.2d 1055 (1979) (determination of cost of capital is basically a matter of judgment which should be left to the regulatory agency and not disturbed absent an abuse of discretion).

The rate base is the value of the property of the utility that is used and useful in providing utility service.*Pennsylvania Power Company v. Pa. Publ. Util. Comm'n,* 561 A.2d 43, 47 (Pa. Cmwlth. Ct. 1989). In the area of adjustment to rate base, the Commission has wide discretion. *Pennsylvania Power & Light Company v. Pa. Publ. Util. Comm'n,* 516 A.2d 426 (Pa. Cmwlth. Ct. 1985); *UGI Corp. v. Pa. Publ. Util. Comm'n,* 410 A.2d 923, 929 (Pa. Cmwlth Ct. 1980)(UGI case); *Duquesne Light Co. v. Pa. Publ. Util. Comm'n,* 174 Pa. Superior Ct. 62, 69-70, 99 A.2d 61, 69 (1953). However, the adjustments must be supported by sound reasons. *Philadelphia Suburban Water Co. v. Pa. Publ. Util. Comm'n,* 394 A.2d 1063 (Pa. Cmwlth. Ct. 1978).

**1. Plant in service**

The Company projects it original cost of jurisdictional plant in service to be $4,904,470,000 as of December 31, 2012. PPL Electric Ex. Future 1-Rev., Sch. C-1; PPL Electric MB at 18. By page 31 of its Main Brief, the Company requests approval of $2,420,963,000. PPL Electric MB at 31, citing PPL Electric Ex. Future 1-Rev. Sch. C-1.

**2. OCA's proposed adjustment based on proposed adjustments to incentive compensation expense**

OCA recommends that the plant in service be reduced to reflect the capitalized portions of its recommended adjustments to PPL Electric's incentive compensation plan. OCA Exh. KC-1-SR Sched. 1 at 2; OCA MB at 11. This results in a downward adjustment of $1,678,000. OCA Exh. KC-1-SR Sched. 1 at 2; OCA MB at 12.

OCA also notes that its recommended adjustment to the incentive compensation expense will affect the accumulated deferred taxes portion of rate base. Based on its recommended expense adjustment, OCA proposes an upward adjustment to rate base of $696,000 to account for this change in accumulated deferred taxes. OCA Exh. KC-1 Sched. 1 at 2 (lines 12); OCA MB at 14.

As discussed in Section E.1, below, PPL Electric opposes OCA's proposed adjustment to its incentive compensation expenses. Therefore, the Company also opposes OCA's related adjustments to its rate base. PPL Electric MB at 19-20.

Since this decision recommends denial of any adjustments to the Company's claim for incentive compensation expenses (see Section E.1, below), OCA's related adjustments to rate base are also denied.

**3. OCA's proposed adjustment to rate base for payroll expense**

OCA recommends that the plant in service be reduced to reflect the capitalized portions of its recommended adjustment to the Company's payroll expense, based on employee levels. OCA Exh. KC-1-SR Sched. 1 at 2; OCA MB at 11. This results in a downward adjustment to rate base of $1,883,000. OCA Exh. KC-1-SR Sched. 1 at 2; OCA MB at 12.

OCA also notes that its recommended adjustment to the Company's payroll expense will affect the accumulated deferred taxes portion of rate base. Based on its recommended expense adjustment, OCA proposes an upward adjustment to rate base of $781, 000 to account for this change in accumulated deferred taxes. OCA Exh. KC-1-SR Sched. 1 at 2 (line 11); OCA MB at 14.

As discussed in Section E.6, below, PPL Electric opposes OCA's proposed adjustment to PPL Electric's payroll expense. Therefore, the Company also opposes OCA's related adjustment to its rate base. PPL Electric MB at 20.

Based on the disposition of the employee complement below, this proposed adjustment is denied.

**4.** **Depreciation Reserve**

PPL Electric claims its plant in service by subtracting the projected accumulated depreciation from the original cost of the plant in service on December 31, 2012. The Company has claimed $1,812,612,000 in its Accumulated Reserve for Depreciation, based on plant in service for the test year ending December 31, 2012. PPL Ex. Future C-1 at 1. PPL Electric reflected depreciation accruals of $155,248,000, proposing that the Commission recognize annual depreciation expenses of $168,920,000.

The OCA recommends increasing the Accumulated Reserve for Depreciation by $10,417,000 to better match the claimed depreciation expense, which resulted in a corresponding reduction to the rate base of $10,417,000. OCA Stmt. 1-REV at 11-12; Exh. KC-1-Rev. Sched. 2 at 3; OCA MB at 12.

Instead of using the projected depreciation expense for the calendar future test year used by Mr. Spanos ($155,248,000), OCA used the annualized level of expense based on the level of plant projected to be in service at the end of the future test year ($168,920,000). This is the same level of depreciation expense that PPL Electric has reflected in its revenue requirement in this proceeding. OCA St. 1 (Revised), PPL. 10-12. The difference ($10,417,000) is the amount of OCA's proposed adjustment to the depreciation reserve. OCA's adjustment, if adopted, would overstate the depreciation reserve and understate rate base and therefore should be rejected.

PPL Electric MB at 21.

The Company explains further that rate base items are not annualized but are the balances that are projected to be in effect at the end of the year. Annualization applied only to revenue and expense items. PPL Electric MB at 22. The OCA's method of using a non-annualized level of plant in service with an annualized level of depreciation reserve would create a mismatch between plant in service and the accumulated reserve for depreciation, resulting in an overstatement of the accumulated depreciation reserve and a resulting understatement of rate base. PPL Electric MB at 23.

The Company claims that no adjustment is necessary because it is appropriate to utilize an annualized pro forma depreciation expense at the end of the future test year in this proceeding but it is not appropriate to adjust the accumulated depreciation accordingly because it is not the level of the depreciation accrual that PPL Electric will experience during the future test year. PPL Electric Stmt. 13-R at 4; PPL Electric MB at 21.

OCA responds:

In the revenue requirement calculation setting rates, ratepayers are being asked to pay for the full level of depreciation expense, including that applicable to future test year additions during the rate year. Therefore, I believe that it is appropriate for ratepayers to have the full portion of that expense applied to accumulated depreciation. I believe that the full level of depreciation expense proposed to be reflected in rates should also be synchronized and applied to the accumulated reserve.

\* \* \*

In setting utility rates, it is important that the accrued depreciation expense being claimed and reserve on which rates will be set are appropriately synchronized.

OCA Stmt. 1-SR at 4; OCA MB at 13.

Adopting the OCA adjustment so that the ratepayers are paying the full level of depreciation expense, will result in an adjustment to increase depreciation accruals by $10,417,000. OCA MB at 14.

The Company makes a good case for using the accrued depreciation amount of $155,248,000 for calculating the depreciation reserve rather than the claimed $168,920,000 in depreciation expense. As the Company states:

The reserve for depreciation is built up by recording depreciation expense, but the expense recorded is the expense per books for a particular period of time, here calendar year 2012. OCA's proposal to ignore the projected per books depreciation expense and use instead the theoretical, annualized level of expense is not correct. The annualized depreciation expense as of December 31, 2012 will not be recorded on PPL Electric's books during calendar year 2012. Therefore, it is not part of the "build-up" of the depreciation reserve by recording depreciation expense related to plant in service.

PPL Electric RB at 9-10.

Therefore, for the reasons stated by the Company, the OCA's proposed $10,417,000 adjustment should be denied.

**5**. **Working capital**

The Company is claiming $40,506,000 in cash working capital (CWC) and explains that its working capital requirement has four applicable principal components:

a. Cash working capital required for operation and maintenance expenses which is determined through a lead-lag study.

b. Investments in prepayments.

c. An adjustment for accrued taxes.

d. Adjustment for interest payments.

PPL Electric Stmt. 7 at 3; PPL Electric MB at 23.

The total working capital requirement claimed by the Company is $65,303,000. PPL Electric Ex. Future 1-Rev., Sch. C-1; PPL Electric MB at 24.

This issue is included in the discussion below.

**a.** **I&E's Proposed Adjustment to Lag Days**

Cash working capital is the difference between the revenue lag and the expense lag experienced by the utility. The revenue lag is the delay between the provided service and when the payment is received from customers. The expense lag is the delay between when a service is provided to the utility and payment by the utility for that service. PPL Electric Stmt. 7 at 4; PPL Electric MB at 24.

The Company uses a revenue lag of 21.5 days for the average lag between payment of operation and maintenance (O&M) expenses and receipt of revenues. This is the Company's claim that on average, it pays its expenses 21.5 days in advance of receiving the related revenue. I&E MB at 10-11. I&E recommends a reduction in the O&M claims, based on its review of the Company's contracts with its affiliate, PPL Services Corporation, and I&E witness Morrissey's determination that PPL unnecessarily pays it affiliate for services it renders to PPL Electric substantially before the required due date. The Company pays its affiliate on the 20th of each month, which is 40 days before the payment is actually due. I&E recommends changing the payment date to the PPL affiliate which, when weighted with the other expense groups, results in an overall average expense lag payment of 47.5 days compared to PPL's claimed average expense payment lag of 35.6 days and an overall average lag between the payment of O&M expenses and the receipt of revenue of 9.6 days. I&E Stmt. 2 at 56; I&E MB at 12.

The Company responds by stating that it does not treat affiliates any differently than it does external vendors, and that a payment for services within 30 days of service is commercially reasonable. In addition, this is consistent with long-standing practice which has been accepted in prior rate cases. PPL Electric Stmt. 7-R at 3. I&E answers that unnecessary early payment creates an approximate $1 million additional rate revenue through the CWC. I&E Stmt. 2-SR at 62; I&E MB at 13. I&E recommends directing the Company to minimize rate impacts on customers by taking advantage of opportunities to decrease expenses whenever possible.

Rate-regulated entities with captive ratepayer customer bases and commercial transactions with unregulated affiliates should be required to seize all opportunities to reduce expenses, especially those of the magnitude of $1 million annually, and not rely on what may be "commercially reasonable" among unaffiliated interest in the un-regulated competitive market.

I&E MB at 14.

I&E seeks a $13,021,000 O&M reduction to the CWC component of the Company's claimed rate base. I&E MB at 14.

The utility management discretion doctrine holds that as a general matter, utility management is in the hands of the utility, and the Commission may not interfere with lawful management decisions, including decisions related to the necessity and propriety of operating expenses, unless on the basis of record evidence, it finds an abuse of the utility's managerial discretion. *Emporium Water Company v. Pa. Publ. Util. Comm'n,* 955 A.2d 456, 465 (Pa. Cmwlth. Ct. 2008); *National Fuel Gas Distribution Corp. v. Pa. Publ. Util. Comm'n,* 464 A.2d 546, 559 (Pa. Cmwlth. Ct. 1983). However, the utility bears the burden of proving the reasonableness of each element of its claim. *Popowsky v. Pa. Publ. Util. Comm'n,* 869 A.2d 1144, 1152 (Pa. Cmwlth. Ct. 2005). Where, for example, that utility is causing the ratepayers a substantial amount of money because of a practice that it cannot otherwise justify except by saying that it has always been done that way, then the claim for it should be disallowed. I&E's argument that PPL Electric does not have to pay its affiliate for its services within the time period the Company claims but has the discretion to take advantage of a longer payment period based on the terms of the contract with its affiliate, is persuasive. Therefore, I&E's recommended adjustment to the Company's claimed CWC should be accepted.

**b. I&E's Proposal Regarding Postage Expense**

The CWC is comprised of four relevant components: O&M expense, average prepayments, accrued taxes, and interest payments. I&E comments that the Company places the same postage expense in more than one CWC component by listing it as both an O&M expense and a prepayment, which overstates that expenditure.

The Company responds that there is no double recovery and cites the following quote from the Commission's 2004 rate case Opinion and Order:

Based on the evidence in record, we deny the Exceptions of the OCA and adopt the recommendations of the ALJ. We find that the Company's position, that the period of time captured in its lead/lag study for this issue is from the date bills are mailed to the date payment is received from customers effectively refutes OCA's argument of double counting, since the time period from when the postage is paid to when it is expensed is excluded.

*Pa. PUC v. PPL Electric Utilities Corporation,* Docket No. R-00049255 (Opinion and Order of December 22, 2004) at 12.

However, the ALJ in that case had found that only the Company had presented evidence:

If OCA is correct, and the Company has included the balance of prepaid postage in rate base to reflect the fact that it purchases postage in advance of using it to send bills, it has not cited any source for this information. The OCA does not dispute that PPL has a prepaid postage balance. However, OCA asserts that the manner in which PPL has measured the postage lead for its lead/lag study fully accounts for this prepayment. Based on the Company's averments, OCA is not correct. In its lead/lag study, PPL has measured the expense lead for postage expense based on the time it sends bills to its customers until the time the customers pay those bills.

OCA asserts that, based on the evidence submitted by the Company, PPLEU's claim for prepaid postage expense of $361,000 should be removed from rate base. The ALJ cannot agree with the OCA's analysis because the Company states its evidence differently**. If the OCA's statement of the evidence were correct, she would agree with OCA's analysis that allowing this claim would result in a double recovery, and reject the Company's rationale that it is actually covering two separate time periods**.

*Pa. PUC v. PPL Electric Utilities Corporation,* Docket No. R-00049255 (Recommended Decision of Administrative Law Judge Allison K. Turner dated October 21, 2004)(emphasis added).

In the 2004 case, the Commission accepted the ALJ's assertion that the evidence did not support a finding that the Company prepaid its postage, which the ALJ admitted would have changed her recommendation. Note that here, the Company admits to prepaying for postage and then using the prepaid postage in its postage meter. However, I&E does not allege a double recovery. Rather, I&E witness Morrissey states that including the same CWC need for postage in both the O&M and prepayment components improperly inflates the CWC calculation:

The Company not only includes a full 12-month expense dollar amount claim for postage in its total CWC O&M expense, but also includes a 12-month average prepayment dollar amount for postage in the Prepayment CWC component. This overstates the actual CWC requirement for postage because the collective inclusion of postage dollars in two different CWC components results in a funding claim greater than what is actually incurred on an annual basis. While not making a specific adjustment for this issue, the Company should be ordered to discontinue this practice in future proceedings as an improper CWC calculation that overstates its CWC needs.

I&E MB at 18.

I&E is correct. Postage dispensed through a postage meter is paid for only once, and including the same CWC need for postage in both the O&M expense and prepayment components of the CWC calculation improperly inflates the CWC calculation and this practice should be discontinued.

**c. I&E's Proposed Adjustment for Prepayments**

Prepayments are payments made before they are due, which the Company must pay before they are properly charged to expense for accounting and ratemaking purposes. PPL Electric uses the following categories: Commission assessment, insurance, postage and other. PPL Electric MB at 28; PPL Electric Stmt. 7 at 5; PPL Electric Exh. Future 1-Rev. Sch. C-4 at 3. I&E recommends eliminating the Commission assessment from CWC. The question here is whether the assessment paid to the Commission is a "prepayment" for purposes of CWC.

I&E states that the assessment is calculated as a proportion of services which have been provided to the electric utilities in the prior year. I&E characterizes this as "more akin to a tax and, accordingly, should be treated as an expense with an associated lag. The billed expense (assessment) should be matched against the revenue generation time period on which the expense was based, namely, the prior year's jurisdictional revenue. Although funding the PUC's, OCA's, and OSBA's budgets for the following fiscal years, it is not a prepayment for the next year." I&E MB at 16.

Public utilities are assessed in August of a fiscal year for the funding of that same fiscal year. Several large utilities pay their assessments or a portion of them, early, in order to assure continued funding of Commission activities for the first quarter of that fiscal year. PPL Electric is one such utility, as indicated by the letter quoted in the Company's Main Brief at 29. There is no question that the assessment is based on a prior year's revenues but that the application period is the following fiscal year. The I&E request for disallowance should be denied.

**d. OCA's Adjustments to Cash Working Capital**

OCA proposed a number of adjustments to CWC, based on other adjustments it is proposing in this proceeding. OCA MB at 15-16. As OCA witness Koda stated:

The level of cash working capital needed by the Company is affected by the adjustments adopted by the Commission in this proceeding. The level of cash working capital that I am recommending the Commission adopt in this proceeding reflects the test-year operating and maintenance expense and tax adjustments that I am recommending within the body of this testimony. It is appropriate that the cash working capital in this proceeding fully reflect any and all adjustments adopted by the Commission in this proceeding. Combining my recommended changes to the Company's proposed components of cash working capital, including the operating expense portion of cash working capital, accrued taxes, interest payments and a stale data adjustment, yields what I believe to be the Company's appropriate cash working capital requirement.

OCA Stmt. 1-REV at 12.

Accordingly, the OCA recommends the following adjustments to CWC:

Upward adjustment for Accrued Taxes: $3,480,000

OCA Stmt. 1-REV. at 13; OCA Esh KC-1-SR Sched. A at 2(line 7); OCA Exh. KC-1-SR Sched. 4 at 8-9; OCA MB at 15.

Upward adjustment for interest payments: $488,000

OCA Stmt. 1-REV. at 13; OCA Exh. KC-1-SR Sched. 1 at 2 (line 8); OCA Exh. KC-1-SR Sched. 2 at 7; OCA MB at 15.

Downward adjustment for O&M expenses: $1,020,000

OCA Exh. KC-1-SR Sched. 1 at (line 6); OCA MB at 16.

Downward adjustment to account for error in Company data: $1,400,000

OCA Exh. KC-1-SR Sched. 1 at 2 (line 9); OCA Exh. KC-1-SR Sched. 2 at 4 (line 5); OCA MB at 16; OCA RB at 5.

PPL Electric acknowledges that "the final calculation of working capital should reflect the final determinations regarding levels of expenses, preferred stock dividends and interest expense that will be recovered through rates." PPL MB at 23, fn 3. Nevertheless, the Company asserts that OCA's adjustments to CWC should be rejected. PPL Electric MB at 24.

It is understood that the final recommendation regarding CWC depends not only on the disposition of the specific CWC issues addressed above, but also on the disposition of related matters of L&M expenses, taxes, interest, and any other issue that may affect the final calculation of CWC. Note that the Company has accepted OCA's $1,400,000 adjustment to correct any error in the Company's data, rendering it undisputed. OCA MB at 16; OCA RB at 5.

Based on the disposition of the CWC issues discussed above, as well as those relating to all other issues that affect the calculation of CWC in this proceeding, the final CWC amount is determined to be $18,402,000.

**e. Recommendation of jurisdictional rate base**

The Company seeks $2,420,963,000. PPL MB at 31. The OCA recommends reduction from the original amount of $10,953,000. OCA MB at 16. I&E seeks a reduction of $15,801,000. I&E MB at 18.

Based on the recommendations above, the final jurisdictional rate base is 2,407,773,000.

**D. Revenues**

1. Reconnection of service fees.

PPL Electric proposes to increase the fee it charges customers for the reconnection of service under Rule 10 of its Tariff from $15 to $30 during normal business hours and from $21 to $50 during non-business hours. The Company argues that its current reconnection fees have not been changed for over 30 years, and that the proposed increase still will be at or below all but one Pennsylvania EDC. OCA Stmt. 3 at 47-48; PPL Electric MB at 31-32.

OCA does not object but notes that the increases will be likely to fall on those customers who can least afford to pay the fees, the low-income customers. However, OCA points out that the smart meter technology may result in decreased reconnection fees if the technology permits remote reconnection. Therefore, OCA recommends that the Commission require PPL Electric to monitor the costs of reconnections and provide a detailed cost analysis of such reconnections in the next base rate case. OCA MB at 16-17.

The Company responds that it has proposed a pilot program in its Smart Meter Technology Procurement and Installation Plan, Docket No. M-2009-2123945, which is intended to assess the feasibility and cost-effectiveness for using smart meter technology for remote disconnection and reconnection, and therefore, the detailed analysis is not necessary. As OCA did not respond to this in its Reply Brief, it is assumed that there is no disagreement, and no detailed cost analysis will be ordered.

I&E recommends including projected revenue from the increased fees in the Company's miscellaneous revenues in the future test year. The Company has accepted the recommended revenue adjustment of $355,000 with the knowledge that actual payment will be reflected in the Company's next base rate filing. This is no longer an issue in this case. I&E MB at 18-19; PPL Electric MB at 32-33.

**E. Expenses**

The law is clear that a utility is entitled to recover its reasonably incurred expenses. *UGI Corp. v. Pa. Publ. Util. Comm'n,* 410 A.2d 923 (Pa. Cmwlth. 1980). Expenses include such items as the cost of operations and maintenance (labor, fuel and administrative costs, e.g.), depreciation and taxes. *Pennsylvania Power Company v. Pa. Publ. Util. Comm'n,* 561 A.2d 43, 47 (Pa. Cmwlth. Ct. 1989).

**1. Incentive Compensation**

The Company explains that it provides three types of compensation to its employees: base pay, benefits and eligibility for incentive compensation. PPL Electric makes incentive compensation payments to its own employees and reimburses PPL Services for its share of PPL Services' incentive compensation which enables PPL Services to make incentive payments to its eligible employees. PPL Electric Stmt. 3-R at 15-26; PPL Electric MB at 33.

The OCA's final position in this matter is to recommend disallowing half of the incentive compensation expense thereby requiring the shareholders to share equally in the cost of the compensation plans. The OCA recommendation is to adjust the expenses of $4,468,000 for the Company's incentive compensation plan and $4,902,000 related to the PPL Services' incentive compensation plan downward. OCA Exh. KC-1-SR, Sched. 4 at 4; Sched. 1 at 2.

I&E recommends an equal sharing of the claimed incentive compensation expenses between shareholders and ratepayers, resulting in a jurisdictional allowance of $4.459 million and a reduction of the same amount from the Company's claim. I&E claims that the Company has provided no evidence that the incurrence of this cost is necessary for the provision of safe and reliable service at just and reasonable rates. I&E MB at 28-29.

The Company argues that the incentive compensation payments are a part of the total compensation package which was developed and is maintained based, at least in part, on a comparison with those of other employers for comparable positions. If the incentive compensation payments to employees were eliminated, the fixed compensation would have to be raised in order to remain competitive with other employers. "There would be no savings to ratepayers." PPL Electric Stmt. 3-R at 16-17; PPL Electric MB at 34.

. . . the PPL Electric incentive compensation plan has three principal goals. The first is increased shareholder value which includes meeting expectations for earnings per share, achieving targeted credit metrics and utilizing multi-year planning to achieve safe and reliable operations. The second goal is to achieve operational excellence, which includes maintaining and improving reliable and safe operations, meeting stakeholder expectations and assuring public and employee safety by maintaining company compliance and optimizing risk management. The third goal is optimizing work force readiness and engagement, which includes preparation for leadership succession, development of plans to close anticipated talent gaps with a diversity focus and values driven performance excellence.

PPL Electric MB at 35-36.

No party has challenged the reasonableness of the total compensation expense. Therefore, the overall amount is not at issue, simply the method of delivering it. As the Company points out, the Commission has approved incentive compensation programs in numerous prior rate cases. *See, e.g.*, *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 2008 Pa. PUC LEXIS 50, Docket No. R-00072711 (July 31, 2008); *Pa. P.U.C. v. Duquesne Light Co.*, 63 Pa. PUC 337, 1987 Pa. PUC LEXIS 342 (March 10, 1987). "In fact, the Commission approved the PPL Corporation incentive compensation payment program for ratemaking purposes in *Pa. P.U.C. v. PPL Gas Utilities Corporation*, R-00061398, p. 40 (Feb. 9, 2007)"(*PPL Gas*). PPL Electric MB at 36-37.

While the two public advocates rely on the inherent fairness of having shareholders fund half of the incentive program, as shareholders are benefitting from it also, the law does not support that concept. Rather, a utility is entitled to recover in rates all expenses reasonably necessary to provide service to its customers and to earn a fair return on its investment in plant used and useful in providing service. To require a sharing of expense is to deny that portion in a rate case, which is simply not permitted under case law. *Butler Township Water Co. v. Pa. Publ. Util. Comm'n,* 473 A.2d 219 (Pa. Cmwlth. Ct. 1984); *T.W. Phillips Gas and Oil Co. v. Pa. Publ. Util. Comm'n*, 474 A.2d 355 (Pa. Cmwlth. 1984).

The proposed adjustments to incentive compensation are denied.

**2. PPL Services**

The Company explains:

PPL Electric is a member of a larger corporate system which includes PPL Corporation and its various direct and indirect subsidiaries. In order to reduce duplication of functions within the PPL Corporate System, various administrative and general services are provided to PPL Electric and its affiliates from a central source, PPL Services. PPL Electric St. 3-R, p. 2. These services are provided pursuant to a services agreement, dated April 27, 1995. A copy of the services agreement is provided as Ex. 1, Attachment II-D-8a.

Services provided by PPL Services are either direct or indirect in nature. Direct services are performed specifically for the affiliate charged. Indirect services, in contrast, benefit more than one affiliate. As a result, indirect costs are allocated among the various affiliates. The indirect cost allocation methodology and procedures are explained in Ex. 1, Attachment II-D-8b to the filing.

I&E has recommended adjustments to expenses for PPL Services for environmental management, external affairs, facilities management, Office of General Counsel, and Office of the Chairman. I&E St. 2, pp. 19-30. Below, PPL Electric explains that each of these adjustments recommended by I&E should be rejected. These adjustments are based almost exclusively on historic averages. History may be useful as a guide or a check on expenditures, but it should not be the basis for setting prospective rates. In each instance, PPL has shown that the historic average does not reasonably reflect future conditions and does not produce an appropriate expense allowance. I&E’s use of historic averages is a further example of I&E’s mistaken belief that rates should be set based on actual expenses. I&E St. 2-SR, p. 3. I&E’s belief has not been correct since the legislature authorized public utilities to submit rate cases using future test years in 1978. 66 Pa.C.S. § 315(e), Act of July 1, 1978, P.L. 598, No. 116, § 1.

PPL Electric MB at 40.

I&E recommends adjustments on a number of categories, discussed individually below.

**a.** **Environmental Management**

I&E recommends levelizing a four-year average of actual annual jurisdictional direct support fees for the years 2009 through 2011, and the 2012 budget for the fees, resulting in a ratemaking allowance of $364,000, or a reduction of $103,000 from the Company's budget. I&E Stmt. 2 at 20-21; I&E MB at 32-34.

The Company responds that new regulations have been adopted that require the Company to undertake greater levels of environmental management activities, construction will increase, and while a new software has been implemented and that cost is not to be repeated, additional employees will be added to work on the system.

The Company does not provide citations to the new regulations nor any specific cost estimates for specific requirements to support its claim that there will be additional costs for compliance. The Company has not sustained its burden of proving entitlement to the level of support fees sought. In the absence of its evidence, the I&E recommendation to levelize a four-year average is reasonable and is granted.

**b. External Affairs**

External Affairs provides, in part, for the coordination of government relations activities, corporate communications, such as media and public relations services, as well as community and economic development activities. The Company's total FTY (future test year) claim for External Affairs is $2.602 million, which is also the jurisdictional portion of the claim.

PPL Electric Stmt. 2 at 21-22; I&E MB at 34.

PPL Electric's budget for 2012 includes $2,602,000 for direct services from the External Affairs department of PPL Services. PPL Electric Stmt. 3-R at 6; PPL Electric MB at 43.

I&E recommends reducing the O&M External Affairs cost by $620,000. This number is the I&E rejection of the Company's claimed 81% increase in expenses with nothing to support it but the claim that the historic test year charged the Company with 25% of the total corporate costs, while the future test year charges it with 36% because:

. . . a review of the day-to-day activities of the regional community relations directors, who are part of the External Affairs Department, has revealed that these activities center around reliability, connections and disconnections, billing and payment, street lighting and requests related to economic development. All of these activities directly benefit PPL Electric and not other members of the PPL corporate system. Therefore, these expenses now are being directly charged to PPL Electric instead of being allocated as indirect charges among all members of the PPL corporate system. PPL Electric Stmt. 3-R at 6-7.

PPL Electric RB at 36.

The Company states that increases in line siting and upgrading work, tree trimming and enhanced storm damage communication protocols have added to the responsibilities of this department. PPL Electric RB at 36-37. "Certainly, the Commission would want PPL Electric to be responsive to its customers and the public in its services territory." PPL MB at 45.

Certainly it does. However, it also needs to see some support for the level of increased funding the Company is requesting, and the Company points only to a schedule attached to rebuttal testimony. I&E provides sufficient rationale to support the reduced increase that it recommends, and that reduction is granted.

**c. Office of General Counsel**

Legal services to PPL Electric are provided by PPL Corporation's Office of General Counsel (OGC), and the Company’s total FTY claim for OGC is $8.386 million, the jurisdictional portion of which is $6.083 million. According to I&E, the Company’s claim is based on its HTY expense increased by $1.2 million in estimated costs for outside counsel fees related to this proceeding. Because of this, I&E witness Morrissey recommends a ratemaking allowance of $4.833 million for OGC expense, which is a $1.2 million reduction to the Company’s claim. The basis for Ms. Morrissey’s adjustment is to eliminate the additional expense associated with outside counsel for this proceeding since the Company also includes a claim for rate case expense in its pro forma adjustment.[[5]](#footnote-5)I&E MB at 38.

PPL Electric agrees with the adjustment but argues that "it is more appropriate to eliminate the duplication from operation and maintenance expense because the expense in question will be incurred by the Office of General Counsel and then charged directly to PPL Electric. PPL Electric St. 8-R, pp 41-42." PPL Electric MB at 47.

I&E acknowledges Mr. Kleha’s acceptance of the expense reduction, but contends that it is appropriate to reflect the reduction as a part of the affiliate support allocation, and not as a rate case expense reduction. By keeping the expense as a part of PPL Electric’s affiliate support allocation as Mr. Kleha has, that expense category will overstate the level of OGC affiliate support dedicated to the provision of electric distribution service in years when there is no rate case. In other words, ratepayers will be allocated an inflated portion of OGC expenses based upon rate proceeding expenses that are not provided annually or regularly by OGC. Further, the overstated level of OGC affiliate support allocated to PPL Electric in this proceeding will then be used in future proceedings to support similarly overstated OGC allocations.

PPL’s transactions with its affiliates must be strictly scrutinized and properly accounted for in order to protect against inflated allocations. In order to avoid overstating the appropriate corporate allocation expense and confusing the appropriate level of affiliate support to the Office of General Counsel in this or future rate cases, PPL’s accepted reduction of $1.2 million should be reflected as a reduction to its Affiliate Support (Direct) – Office of General Counsel expense claim.[[6]](#footnote-6)

I&E MB at 38-40

I&E makes a valid point. In order to prevent the overstatement of legal expenses in non-rate case years, this reduction should be to the Affiliate Support (Direct) – Office of General Counsel expense claim.

**d. Office of Chairman**

I&E argues that the Company claim for its share of the support for the Office of the Chairman of PPL Corporation is overstated:

Indirect Support overall represents general and administrative support that is not readily identified as being incurred for a specific affiliate but is generally characterized as benefitting all PPL Corporation subsidiaries. The Office of the Chairman expense is a component of indirect support. The Company’s total jurisdictional future test year claim for Office of Chairman is $1.010 million.

I&E MB at 40 (footnote omitted).

I&E recommends using the equivalent of the historic test year amount, $623,000, which is a $387,000 reduction to the Company’s claim. The basis for I&E’s recommendation is

to recognize the historical experience which, as the table below demonstrates, shows the declining historical experience regarding these costs.

|  |  |  |  |
| --- | --- | --- | --- |
| **YEAR** | | | |
| **Historic Actuals** | | | **FTY Claim** |
| **2009** | **2010** | **2011** | **2012** |
| $979,000 | $738,000 | $623,000 | $1,010,000 |

I&E points out that there are two new rate-regulated entities, LG&E and KU Energy, LLC (jointly LKE) that should also absorb a portion of the Indirect – Office of Chairman costs on a prospective basis, and that the addition of more affiliates further justifies a reduction of PPL Electric’s portion of these prorated costs. I&E Stmt. 2 at 28-30.

PPL witness Cunningham asserts that these acquisitions have already been reflected in the allocation of PPL Services indirect support fees. Ms. Cunningham also asserts that PPL Services has conducted a review of affiliate allocations, and that using a Commission-approved three-factor approach has justified a larger allocation of the Office of Chairman expense to PPL Electric. I&E Stmt. 2 at 28-30.

I&E acknowledges the Company’s use of the three-factor approach as well as the fact that that same approach was used over the historic years reviewed. That approach indicates declining allocation of costs. I&E points out that no other indirect expense allocations have increased to the same extent claimed by PPL Electric for Office of Chairman indirect expense allocation, a 62% increase over the historic test year and exceeding even the 2009 cost prior to the inclusion of the three new affiliates. I&E MB at 41.

The Company refutes the adjustment:

Specifically, in 2011, PPL Services undertook an extensive review of the allocation of PPL Services support group fees, including the Office of the Chairman. This review resulted in an adjustment to the allocation of related expenses to better match the benefits they provide to affiliates. This initiative resulted in a greater allocation of certain PPL Services support group fees to PPL Electric. PPL Electric St. 3-R, p. 14.

In addition, as explained previously, indirect support fees are allocated using a three-factor formula recommended by the Commission. As explained in Exhibit 1, Attachment II-B-8b, page 1, the three-factor indirect cost allocation formula reflects invested capital, operation and maintenance expenses and the number of employees. PPL Electric’s portion of these factors in the Corporate System increased in 2012, which resulted in a greater allocation of certain indirect costs to PPL Electric. These factors, taken together, resulted in an increase in the allocation of indirect support fees from the Office of the Chairman from 2011 to 2012.

PPL Electric MB at 38.

I see insufficient support for a 62% increase in support for the parent corporation's Office of the Chairman, and therefore, accept I&E's adjustment.

**3. Storm Damage Expenses**

PPL Electric's claimed storm damage expense includes: (1) future test year budget for normal storm damage expenses of $12,625,000; (2) the premium for storm damage insurance of $8,750,000; and (3) a proposal to amortize over five years the extraordinary storm expenses in excess of insurance recoveries incurred during major storms in August 2011, Hurricane Irene, and October 2011 at $5.324 million per year for five years. PPL Electric Stmt. 2-RJ at 3-6; PPL Electric Exh. GLB-9; PPL Electric MB at 48.

**a. Future test year budget for storm damage**

The future test year budget for normal storm damage is $12,625,000, which includes $3,175,000 for non-reportable storms not covered by insurance and $9,450,000 for the portion of reportable storms that are subject to the expense portion of the insurance deductible and not recoverable under the insurance policy. No party has taken issue with the proposed budget amount, and therefore, it is approved.

**b. Storm Damage Insurance**

The proposed premium amount of $8,750,000, which purchases $18,250,000 of recovery, subject to an annual deductible of $15,750,000, is in dispute.

I&E opposes the insurance portion of the storm damage claim for several reasons: (1) the insurer is a PPL affiliate; (2) the purchase of storm damage insurance is advantageous to the affiliate; (3) claims are not presented in a timely fashion, which leaves the utility to finance short-term costs while the insurance company uses the premiums in excess of 12 to 18 months; and (4) the combined costs of the premium and deductible outweigh the value of the insurance provided. I&E MB at 43-44.

The Company disputes the claim that its purchase of insurance was imprudent as it was approved as part of a settlement of the 2007 rate case and was not opposed by I&E. PPL Electric MB at 56. The Company is correct, and the claim that the purchase of insurance is imprudent is denied. However, the continued use of insurance may be examined.

I&E questions the use of an affiliate in providing insurance, as it presents a "heads I win, tails you lose" advantage to the corporation. It states that the premiums are too high, the purchase of insurance has not saved ratepayers money because they bear the time value of money due to the delay in presenting claims and their ultimate payment.

I&E avers that the Company's numbers were not possible:

As I&E witness Morrissey noted in surrebuttal, however, Mr. Banzhoff's numbers were mathematically impossible, because the amount of the 2012 deductible, $15,750,000, exceeded the $12,625,000 budgeted in O&M for 2012 for normal storm repair. As I&E demonstrated in its Main Brief, it was only hours before Mr. Banzhoff was to be cross-examined that an explanation for this mathematical impossibility was provided: "Historically storm costs are charged 60% to expense and 40% to capital."[[7]](#footnote-7) However, while PPL characterized this allocation as "historic," in reality Mr. Banzhoff acknowledged that this allocation was conducted for the first time in 2012.

I&E RB at 35.

A single year cannot reasonably be characterized as "historic" and this type of misleading inaccuracy calls into question the credibility of the witness.

Next, the Company attempts to discredit Ms. Morrissey's figures by claiming that she has double-counted the deductible, which, the Company explains, is a subset of the budgeted amount for storm damage expense. Accepting this, I&E developed the following chart using Company data to develop a recommended budget for non-reportable storm damage.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** |
| O&M expenses for storm damage repair | $7,500 | $8,743 | $8,161 | $9,847 | $11,057 | $12,625 |
| Storm Insurance Deductibles | $7,500\* | $7,500 | $7,500 | $7,500 | $ 7,500 | $ 9,450 |
| Budget for non-reportable storm damage | $0 | $1,243 | $ 661 | $2,347 | $ 3,557 | $ 3,175 |

I&E RB at 37.

As is evident, if the deductible is included in O&M from 2008 to 2012, the budget varied greatly over a period of six years. This mysterious inconsistency is used by I&E to support its averment that the Company already has budgeted a normal level of storm damage expense sufficient to recover its 2011 and 2012 storm damage expenses. I&E RB at 38.

The Company responds with its claim that I&E has still double-counted the deductible, but this is not evident. PPL Electric claims further that the insurance company, PPL Insurance, is not profitable and that, over the five years that the storm damage insurance has been in effect, PPL Insurance has lost money. Its capital and surplus decreased from $12,378,416 as of December 31, 2006, to $6,533,494 as of December 31, 2011. I&E Ex. 2-SSR, Sch. 1, Att. 1 at 4, p. 4; PPL Electric MB at 57. The Company claims:

The losses incurred in 2011 reduced PPL Insurance's statutory capital and surplus to a level that is less than $3 million above the required minimum. If PPL Insurance were to incur storm losses in 2012 similar to those incurred in 2011, it would not have sufficient remaining capital and surplus to retain its license to write insurance under Bermuda law.

PPL Electric Stmt. 14-RJ at 12-13; PPL Electric MB at 57-58.

The Company explains that the purpose of purchasing insurance is to spread losses over an extended period of time and to provide PPL Electric with access to the reinsurance market, which is the source of non-affiliated storm damage insurance available. PPL Electric Stmt. 14-RJ at 5.

The following chart shows payments in premiums and its reimbursements from its affiliated insurance company:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **2007** | **2008** | **2009** | **2010** | **2011** | **Total** |
| ($000) | | | | | | |
| Premiums | $6,725 | $7,260 | $6,960 | $10,850 | $10,850 | $42,645 |
| Reimbursements | $12,112 | $5,032 | $0 | $5,499 | $26,500 | $49,143 |

PPL Electric RB at 24.

The Company has adequately explained its use of insurance, and its claims are approved. The issue remaining is the value of money due to the delay in processing claims. I&E points out that the PPL witness Novatnack testified that the Company was required to present only one aggregated claim under the policy, but that reviewing the policy resulted in a change of testimony admitting that it was Company's policy, not the insurance company's requirement at all. This results in an inevitable delay in the payment of claims from the time that the loss is incurred, and provides a benefit to the insurance company to the detriment of the ratepayers. As the amounts of the recovery from the insurance company can be substantial, PPL Electric should be directed to cease this practice and to file its claims on a more frequent basis.

**c. Storm Damage Reserve Account**

The I&E recommendation that this Company may be better off with a storm damage reserve account or rider is worth pursuing:

If PPL had utilized a risk management approach with a storm reserve account within the regulated utility, its profitability would not have been impacted by the storm costs that exceeded the insurance limit as the storm reserve account's accumulated balance would have shielded PPL from the large storm expenses encountered in 2011. Through its existing risk management policy, however, PPL essentially shifts ratepayer funds out of the regulated utility and to the corporate family by way of PPL Power Insurance. The mere failure to provide PPL Electric timely access to insurance proceeds for over one year contributes to PPL Electric's lower realized rate of return, which then, supplies PPL Electric purported ground to support its proposed $104.6 million rate increase. This storm risk management policy has not proven to be cost-effective to ratepayers and should be terminated.

I&E Stmt. 2-SSR at 4-5; I&E MB at 54.

As I&E argues, "even the mere appearance of a financial benefit flowing to affiliated entities as a result of PPL Electric's storm damage insurance practices with its affiliate should be sufficient to find against continuation of this practice." I&E MB at 52.

PPL Electric "is not conceptually opposed to such a mechanism for recovery of storm damage costs" and had proposed it in the 2007 rate case. The settlement in that case, coupled with the opposition of the parties, resulted in the matter being dropped. However, the Company objects to the grant of this proposal without the details. PPL Electric MB at 70.

The insurance proposal was approved in 2007, and sufficient time has elapsed to find that it is not being used to the benefit of the ratepayers. PPL Electric should be directed to develop a plan for establishment of a storm damage reserve account and to submit it for approval. If approved, it should be implemented when the insurance coverage provided by its present provider expires. It is recommended that the public advocates be included in the development of this program.

**d. Amortization**

Next, the Company seeks the authority to amortize extraordinary storm damage expenses incurred during 2011 over five years, meaning $5,324,000 annually for a total of $26,324,000. PPL Electric Ex. Future 1-Rev., Sched. D-9; PPL Electric MB at 62. PPL Electric points to two petitions seeking the authorization to defer these costs, both of which authorize the Company to defer the costs and specifically state that they do not find whether the costs are extraordinary or prudently incurred. As such, the Commission Orders state that they carry no factual weight in an evidentiary proceeding. *Petition of PPL Electric Utilities Corporation for Authorization to Defer, for Accounting Purposes, Certain Unanticipated Expenses Relating to Storm Damage,* P-2011-2270396 (Opinion and Order entered December 15, 2011)(Hurricane Irene Petition); *Petition of PPL Electric Utilities Corporation for Authorization to Defer, for Accounting Purposes, Certain Unanticipated Expenses Relating to Storm Damage from the Late October 2011 Snowstorm,* P-2011-2274298 (Opinion and Order entered December 15, 2011)(Halloween Snowstorm Order). The costs were properly deferred, and the analysis turns to whether they were extraordinary and were prudently incurred.

As the Company states, Hurricane Irene resulted in outages to approximately 428,503 customers and caused $21,542,000 in damages. PPL Electric MB at 63. The Halloween storm interrupted service to approximately 388,318 customers, causing damages in the amount of $23,213,000. PPL Electric Exh. GLB-10 details the deferred amounts. The total cost of repair and restoration caused by reportable storms in 2011 is the highest in PPL Electric's history at $85,916,000l. PPL electric Stmt. 14-R at 5; PPL Electric MB at 63.

I&E argues that the cumulative five year total costs incurred for storm expense fall below the cumulative total amount budgeted in that same five year period, which, in

essence, renders the level of expenses incurred by the Company from the storms to be ordinary. I&E Stmt. 2 at 37. Further,

As calculated by I&E, from 2007 through 2011, PPL budgeted $124.6 million for normal storm damage expenses and insurance based upon data provided by PPL for expenses and insurance based upon data provided by PPL for expenses related to insurance premium, insurance deductible, and normal storm allowance. However, PPL only experienced $118.9 in total storm expenses over the same time period. Since ratepayers have paid rates over that same time period based upon budgeted storm expense amounts that should have been sufficient to cover PPL's experienced storm damage expenses on a normal basis, no extraordinary relief is warranted.

I&E MB at 56 (footnotes omitted).

The Company is entitled to recover its prudently incurred expenses, and the amounts are not in question. Therefore, the 2012 budget amount and five-year amortization of 2011 storm damage costs in excess of insurance are approved.

**4. Payroll**

PPL Electric seeks a budget for payroll on an employee complement of 2,002, which it states is necessary for the management and maintenance of the Company's transmission and distribution systems in order to meet the needs of customers. PPL Electric Stmt. 2-R at 8-9; PPL Electric MB at 71.

OCA proposes reducing the payroll budget to allow for an employee complement of 1,943, which is PPL's average number of employees over the sixteen month period prior to March 2012. OCA Stmt. 1-REV at 1718, Exh. KC-1-REV, Sched. 4 15 3; OCA MB at 18. This would amount to a reduction in the wages, payroll taxes and benefits by $3,740,000. OCA Stmt. 1-REV at 17. The Company protests that it is in the process of filling 106 positions. PPL Electric Stmt. 2-R at 8; PPL Electric MB at 72.

OCA argues that the budgeted staff levels should be reasonably based on historic data. *See e.g., Pa. Publ. Util. Comm'n v. PPL Gas Utilities Corporation,* 255 P.U.R. 4th 209, 242 (Pa. PUC 2007)(utility's complement claim was reasonable and supported by the record where at times the actual number of employees was greater than budgeted, because the number was supported by historic data.) OCA MB at 18. OCA points out that the Company's employee level

had declined from December 2010, when it was at 1,974, to June 2012, when the complement was at 1,943 employees. OCA MB at 19. Because the Company had neither claimed nor proven that the lower complement had resulted in inadequate service, there is no evidence to support a need for the higher number of employees. OCA MB at 19.

The OCA makes a very good point. The Company's actual employee complement for the first three months of the future test year was far less than budgeted, with 60 fewer in January, 71 fewer in February, and 83 fewer in March. OCA Stmt. 1-REV, Exh. KC-1-REV. Sched. 4 at 3; OCA RB at 6. As of June 2012, the Company's complement was 1,942, which was still one person lower than the OCA recommendation. OCA RB at 6. However, the utility is most familiar with its own needs in terms of staffing, and the historical payroll supports a finding that the Company's claim is reasonable.

**5. Uncollectible Expenses**

PPL Electric's total future test year uncollectible accounts expense is $42,098,806. PPL Electric Ex. JMK-4; PPL Electric MB at 72. This amount includes an amount for expected write-offs plus any change in the reserve for doubtful accounts due to increased accounts receivable, which are subject to write-off. PPL Electric Stmt. 8-R at 32; PPL Electric MB at 72.

I&E challenges the proposed change in reserve for doubtful accounts as not permitted. *Barasch v. Pa. Publ. Util. Comm'n,* 493 A.2d 653, 655 (Pa. 1985)("Although the Commission is vested with broad discretion in determining what expenses incurred by a utility may be charged to the ratepayers, the Commission has no authority to permit, in the rate-making process, the inclusion of hypothetical expenses not actually incurred. When it does so, as it did in this case, it is an error of law subject to reversal on appeal."). The fact that this rate case is using a future test year permits forecasting in terms of using real data to forecast the final uncollectibles for 2012, which is sufficient to ensure that the Company's uncollectibles will be covered. "Doubtful accounts" presents an unmeasurable and unsupported factor which will not be included here.

I&E Witness Morrissey prepared a table showing the actual new write-off uncollectible percentages from 2007 to 2011:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Actual Net Write-Off Uncollectible Percent | | | | |
| 2007 | **↑** 2008 | **↓** 2009 | **↓** 2010 | **↑** 2011 |
| 1.57% | 1.72% | 1.63% | 1.49% | 1.97% |

I&E MB at 22.

As is evident, the highest percentage is still well below the Company's requested 2.23%. There is insufficient justification to permit this percentage now.

I&E uses a five-year calculation, which includes four years of recession and two years post-rate cap. The final I&E recommendation is based on a three-year average, confirmed by a five-year average, yielding a 1.70% uncollectible rate. I&E recommends an uncollectible expense allowance of $1,779,000, which represents a reduction of $554,000 from the Company's claim. This is reasonable and recommended for approval.

**6. Revised Rate Case Expense**

An allowable claim for rate case expense includes those costs prudently incurred to compile, present, and defend a request to increase base rates, such as legal fees for outside counsel and consultants, printing and postal expenses. *Butler Twp. Water company v. Pa. Publ. Util. Comm'n,* 473 A.2d 219 (Pa. Cmwlth. 1984). There is no hard and fast rule which requires the Commission to allow the entire rate case expense. *UGI* at932; *Peoples Natural Gas Co. v. Pa. Publ. Util. Comm'n,* 34 A.2d 375, 386 (1943).

I note that the original filing included an amortization of PPL Electric's remaining rate case expense of $674,000 from the 2010 rate case and the normalization of the present case's $1,013,000 cost over a two-year period. PPL Electric Exh. JMK-2 at 20; PPL Exh. Future 1, Sched. D-6. The Company dropped this proposal during litigation and withdrew the amortization request. This resulted in a downward adjustment of $674,000 to the proposed expenses. PPL Electric Stmt. 8-R at 42; PPL Electric Exh. Future 1-Rev. PPL Electric MB at 75. In addition, PPL Electric inadvertently includes $1,200,000 of rate case expense twice, once in PPL Electric Exh. Future 1, Sch. D-6, and again as a charge from PPL Services. This was removed from O&M expense. PPL Electric MB at 75.

PPL Electric seeks a two-year normalization, which it argues is appropriate given the pressure that its capital spending program will place on earnings:

In 2013, PPL Electric plans to spend $870,000,000 on capital projects, and for 2014, PPL Electric expects to spend $821,000,000 on capital projects. The total increase in plant added will be almost $1.7 billion. In contrast, PPL Electric’s net measure of value, for total transmission and distribution operations, is approximately $3.3 billion. PPL Electric Ex. Future 1-Revised, Sch. C-1. In other words, plant additions during 2013 and 2014 will exceed 50 percent of PPL Electric’s total projected net measure of value as of December 31, 2012. It is difficult to see how such a significant increase in rate base and plant in service would not drive a rate case during 2014 or before. The possibility that PPL Electric may be able to avail itself in the future of a distribution system improvement charge offers little comfort since the DSIC is capped at 5 percent of revenues. 66 Pa.C.S. § 1358(A)(1); *Implementation of Act 11 of 2012,* Docket No. M-2012-2293611, Final Implementation Order, pp. 40-41 (Aug. 2, 2012). The DSIC will do little to offset the revenue requirement associated with PPL Electric’s substantial capital program. PPL

Electric’s proposed two-year period for normalization of rate case expense should be approved.

PPL Electric MB at 76.

OCA advocates using a three-year period because the utility's last three rate cases, 2004, 2007, and 2010, were held exactly three years apart. It is the historical filings, not the actual intentions of the utility, which will guide the determination of the normalization period. *Pa. Publ. Util. Comm'n v. City of Lancaster,* R-2010-2179103, et al. (Opinion and Order entered July 14, 2011), 2011 Pa. PUC LEXIS 1685; *Pa. Publ. Utility Comm'n v. Metropolitan Edison Company,* R-00061366, et al. (Opinion and Order entered January 4, 2077), 2007 Pa. PUC LEXIS 5; OCA MB at 26.

I&E agrees that the normalization period should be determined by the historical filings and recommends 32 months, which is the result of adding the 36 months between the 2004 to 2007 filings to the 36 months from 2007 to 2010 with the 24 months from 2010 to 2012, and dividing by 3. I&E MB at 26. I&E's recommendation is based on solid evidence and should be approved. This results in a disallowance of $258,000 to the rate base.

**7. CEO's increase to low income usage reduction program**

The Company has proposed no changes in its universal service programs nor to the funding for them, as these are subject to separate proceedings. *PPL Electric Utilities Corporation Universal Service and Energy Conservation Plan for 2011-2013,* Docket No. M-2010-2179796 (Opinion and Order entered May 5, 2011)(*USP* case). This was a litigated proceeding, with the participation of interested parties.

CEO argues that the Company's last increase of $250,000 in the 2011-2013 USP case, is inadequate to serve the needs of the low-income customer base. CEO disagrees with the Company's position that a base rate case is not the proper place for this argument, citing former rate cases which have evaluated the low-income plan budgets.

Both sides are correct. Base rate cases are the traditional forum for budgets of low-income plans, but in recent years, the Commission has required companies to file separate cases which include the universal service plan budgets. This Company has a Commission-approved plan in place, including the budget. The plans for EDCs are filed every three years and they concentrate on the programs included in the customer assistance portfolio. However, in a base rate case, any part of the Company's tariff may be brought into question. As an issue which is raised by another party, the burden of proving that the universal service issues deserve additional funding belongs to the party raising it – here, CEO.

CEO points out that the funding for WRAP increased only 3% in the USP case, which translates into an additional 106 customers per year at the average cost of $2,349, an increase not consistent with the increased number of low income customers in PPL Electric's territory, which CEO argues is 44% based on the 2008 census. CEO MB at 5, citing CEO Stmt. 1 at 7. The usefulness of a well-funded LIURP program has long been recognized by the Commission as a tool to lowering heating bills, thus creating a lower heating bill which the customer is more likely to pay. CEO MB at 5-6. In addition, the higher prices resulting from this proceeding will be effective January 1, 2013, a full year prior to the end of the effective period from the current USP case. CEO RB at 2. Refraining from addressing this issue now will deprive low-income customers of timely relief from a rate increase. CEO RB at 3.

The Company counters that the increase in low-income customers in its service territory should not be viewed in isolation. Rather, consideration needs to be given to the cost impact on other residential customers, the ability of the community-based organizations (CBOs) which administer the programs to deliver additional services, and the availability of funding from other sources. PPL Electric advocates the consideration of all of these issues within the triennial filings for approval of the plans themselves, where all entities involved may participate. PPL Electric Stmt. 9-R at 6; PPL Electric MB at 79.

I&E opposes the CEO proposal because it fails to consider the total increase in the funding of universal service benefits in recent years. Since 2004, over three base rate cases, the funding for the OnTrack program increased from $9.5 million to $41.2 million, and from 2000 to 2008, weatherization funding grew from $5.7 million to $8 million. I&E MB at 66-67.

Through 2012 PPL ratepayers will be compelled to contribute $75.35 million annually to the funding of PPL's universal service program benefits. That mandatory ratepayer funding is projected to increase to $78 million by 2014. The trajectory of mandatory ratepayer funding of PPL's universal service benefits has skyrocketed upward, increasing 122% from 2008 to 2011 and projected to increase by 145% through 2014. I&E submits that PPL's ratepayers are contributing sufficiently towards relief for their low-income neighbors. PPL's LIURP funding should remain at its current $8 million.

I&E MB at 68.

The Commission's institution of separate proceedings for these plans is indicative of its preference to address the issues within those proceedings. Therefore, CEO's recommended increase in funding for these programs is denied. CEO is encouraged to participate in the triennial plan reviews and to make its concerns known there.

**8. Consumer Education Expenses**

PPL Electric's consumer education program was mandated and authorized by the Commission’s Final Order in *PPL Electric Utilities Corporation Consumer Education Plan for 2008-2012,* Docket No. M-2008-2032279 (entered July 18, 2008), which was designed to communicate the following Energy Education Standards to customers:

1. The generation component of retail electric rates charged to customers by electric utilities has been capped since 1996, and that the cap for that customer’s service territory will expire on \_\_\_\_\_\_ (as per territory).
2. The rate charged for generation service will change after the rate cap expires, and may significantly increase.
3. Customers can take certain steps before the expiration of the rate cap, and other steps at the time the rate caps expire, that may help them control the size of their electric bills.
4. Customers can control the size of their electric bills through energy efficiency, conservation and demand side response measures. Customers can benefit from utilizing these measures now, even if the rate cap is still in effect where they reside.
5. Cost-effective energy efficiency, conservation and demand side response programs and technologies have been identified and information about them is readily available.
6. Customers may reduce the size of their electric bills, or receive service options more suited to their needs, by purchasing generation service from an alternative electric generation supplier.
7. Current information that will allow customers to make informed choices about competitive generation alternatives is readily available. In territories where there are not competitive offerings currently, more choices may be available once rate caps expire.
8. Programs exist to help low income customers maintain their utility service, and information about them is readily available.

Order of July 18, 2008, at 2.

A review of these Energy Education Standards reveals that the goal was to educate the consumers in each EDC's service territory regarding the expiration of rate caps, ways to reduce energy consumption and thereby lower bills, and the availability of retail competition. The amount of the funding for 2012, $5,482,220, was also approved through 2012, and therefore is recommended to be approved here through 2012.

PPL Electric proposes to recover $5,482,220 for:

. . . ongoing needs consistent with the Company's Consumer Education Plan. In addition, PPL Electric proposed to amortize $400,000 for the 2012 annual Retail Markets Investigation postcard over two years. Recovery should also include a two-year amortization of the amount to be spent on the Retail Markets Investigation Tri-Fold brochure anticipated to be mailed in November, 2012. In addition, PPL Electric proposes to recover all future amounts including but not limited to amounts related to the Retail Markets Investigation EDC letter and amounts that may arise from programs included in PPL Electric’s default service program that are subject to separate and explicate approval. All of the expenses complying with mandates of the Commission, including the Retail Markets Investigation, should be recovered by PPL Electric because they are not currently reflected in rates. PPL Electric St. 5-R, pp. 29-30.

PPL Electric MB at 81.

I&E and OCA oppose portions of the Company's proposal.

I&E points out that the Company's proposed Competitive Enhancement Rider (CER) is designed to recover costs of the Retail Markets Investigation (RMI) initiatives, and that any costs related to education regarding those initiatives should be recovered through that rider and not in base rates. While I&E does not object to recovery of the $1,650,000 RMI costs and the $844,000 costs related to the Eligible Customer List (ECL) mailings, it notes that these should be recovered under the CER, if it is approved, and removed from this section.

I&E states that the Commission and its EDCs are moving into the next phase of retail competition, and that shopping and energy efficiency are more effectively addressed by the Act 129 Energy Efficiency and Conservation (EE&C) Plan and the RMI mandates. These are funded through the Act 129 Rider and the proposed CER.

The goals of both the CEP and the Act 129 Rider benefit PPL Electric's ratepayers by both educating consumers on making decisions and incenting behavior or other changes in ways that reduce the cost and quantity of electricity used. Although each program educates about energy usage reduction in slightly different ways, the overall aim of instructing customers on the efficient use of energy is the same.

I&E Stmt. 2 at 44; I&E MB at 62-63.

OCA recommends that the Company's consumer education funding be approved for $5,400,000 annually. OCA Stmt. 1-SR at 8-0. This amount is based on the approved amount in the 2008-2012 Consumer Education Plan. This results in a downward adjustment of $2,576,000 to PPL's proposed expenses. OCA MB at 29.

The Company objects to the OCA proposal because it would disallow an amount of money equal to the total of the cost of the future annual postcard mailings required under the RMI ($400,000 annually), the cost of the 2012 postcard mailings required under the RMI ($400,000 over two years) and the cost of the tri-fold brochure required under the RMI ($700,000 over two years). There is also no provision for funding future Commission mandates to be issued under the RMI. PPL Electric RB at 20-21.

The Commission's mandates must be funded, and the issue here is the best method of funding. While the Company must be fully reimbursed for its prudent expense, there must be a limit to the amount that should be spent. The I&E proposal is the best choice as it fully funds the Commission's mandates but does not waste ratepayer money on duplication:

It is neither reasonable nor cost-effective to require ratepayers to support duplicate goals at the cost of an additional $5.4 million in rates annually to continue the 5-year CEP when newer programs under Act 129 and the Commission's RMI investigation have evolved to fund and accomplish the same goals. While there is an on-going need to educate consumers about shopping and efficiency, that need is being met by newer programs. As was the case with the Commission's disallowance of PPL's proposed Community Betterment Initiative (CBI) in its 2004 rate case, PPL provided no "concrete record evidence quantifying how" the CEP will benefit ratepayers in ways the Act 129 and RMI programs will not. Continuation of the CEP is not necessary to achieve the same educational and financial goals associated with shopping and efficiency that are now established under the Act 129 EE&C and RMI programs.

I&E RB at 46.

Accordingly, it is recommended that the 2012 budget approved by the Commission in the 5-year CEP be approved here for only 2012, and that the education costs incurred in carrying out the RMI mandates be recovered using the CER, discussed and recommended for approval below.

**F. Rate of Return**

**1. Company proposal**

The Company is seeking an allowed rate of return on equity of 11.25%, along with a capital structure of approximately 51 percent common equity and 49 percent long-term debt, which the Company states are the necessary ratios to successfully raise capital in the present day's financial market conditions:

Much of the Company’s electric distribution system was constructed and placed in service in the 1960s and 1970s. PPL Electric has been able to maintain this equipment in a way that has continued reliable customer service. However, much of that equipment has an expected useful life of approximately 40 years, and is nearing or past the end of that lifespan. The Company has begun to incur increasing maintenance expenses to deal with rising equipment failures, a solution that becomes expensive and does not adequately address long-term reliability. Investment in system replacements will reduce the rate of O&M cost increases, minimize the total cost of doing business and reduce the potential for eroding reliability performance.

In late 2008, the Company began a detailed, comprehensive study to assess the overall equipment age, condition and performance of its transmission and distribution assets. The purpose of the study was to develop a strategy for capital replacement and maintenance improvements that would allow the Company to avoid the anticipated cost and reliability effects of aging infrastructure and bolster its ability to maintain reliable electric service. Based on the results of the study, PPL Electric has embarked on a 10-year capital plan to replace, maintain and improve various distribution assets. In addition, the replacement of older technology with new systems and facilities will improve system reliability by reducing service outages and shortening outage response time.

Replacing and modernizing these delivery system facilities will require PPL Electric to make significant capital investments. Over the past five years, 2007 through 2011, the Company invested almost $1.3 billion in the delivery system, associated information technology and facilities infrastructure. PPL Electric intends to invest an additional $1.6 billion in the delivery system from 2012 to 2016. In 2011, PPL Electric invested a total of $326.6 million in distribution system improvements. The Company plans to make distribution system capital investments of $337 million during the future test year in this case (calendar year 2012). The Company will have to raise a significant amount of money in the capital markets to make those planned investments.

At the time of the last major utility-led infrastructure build-out period in the 1960s and 70s, utility corporate credit ratings were typically at the A to AA- levels. Today, the most common Standard & Poor’s Rating Services corporate credit rating among electric utilities is BBB, which also tends to be about the average for the industry and is just two notches above speculative grade. This downward drift in utility credit ratings reflects the continued challenging business environment and slow economic recovery in the United States, including declining electric sales, increasing operating expenses and the need to fund significant capital investments. Clearly, access to capital at reasonable borrowing rates is extremely important to the Company and, ultimately, to its customers. For these reasons, it is critical that the financial community views PPL Electric as an attractive investment.

Since its last distribution base rate case, Moody’s has downgraded the Company’s credit rating from Baa1 to Baa2. PPL Electric forecasts its return on equity for the distribution business will fall to approximately 6.7 percent in 2012 based on current rates. This return is inadequate by any standard. In this filing, the Company is requesting an allowed return on equity of 11.25 percent, along with a capital structure of approximately 51 percent common equity and 49 percent long-term debt, which PPL Electric believes are necessary ratios to successfully raise capital under today’s financial market conditions.

In light of the business environment described above, PPL Electric believes its requested return on equity is the minimum required to attract needed capital under reasonable terms. Such access to the capital markets will allow the Company to proceed with its proactive strategy to renew and strengthen the delivery system from a position of financial strength. Ultimately, it will enable the Company to execute its plan more efficiently, which will result in lower costs to customers over the long term, maintain reliable service, and create hundreds of jobs. Adequate rate relief also will permit the Company to pursue efforts to improve its bond ratings which, if achieved, would further lower the cost to serve customers.

PPL Electric Exh. Future 1 – Revised, Sch. A1, pp. 3-6.

The rate increase in this proceeding is designed to provide a return on, and a return of through depreciation, the above-referenced substantial investments made by PPL Electric in 2011 and 2012 after the end of the 2010 future test year in PPL Electric’s last base rate case. However, of equal or greater importance, PPL Electric cannot continue to make these investments if its credit ratings are permitted to continue to decline. Accordingly, the capital structure, rate of return on common equity and overall fair rate of return determinations in this proceeding are critical to PPL Electric’s ability to provide continued safe and reliable service to its customers.

Other electric and gas utilities in Pennsylvania also must undertake significant increases in construction activities as they face the same factors as PPL Electric in terms of replacing aging infrastructure installed in post-World War II expansion. See, *Natural Gas Pipeline Replacement and Performance Plans*, Docket No. M-2011-2271982, 2011 Pa. PUC LEXIS 375 (Tentative Order Nov. 10, 2011). Indeed, the Pennsylvania General Assembly and the Governor have recently enacted Act 11 of 2012 creating new rate mechanisms to allow more current reflection of infrastructure investments in rates. In order to be successful, these mechanisms require, however, that the rate of return be adequate to permit utilities to raise capital to replace infrastructure on reasonable terms.

PPL Electric’s rate proceeding will be the first litigated rate case for a major utility decided by the Commission in the recovery following the Great Recession. It, therefore, will be viewed by investors as a bellwether of the Commission’s views and intentions with regard to infrastructure replacement in Pennsylvania. The Commission’s decisions in this case are critical to all Pennsylvania utilities and their customers.

PPL Electric MB at 85-86.

The rate of return is a rate determined by the Commission to allow the shareholders the opportunity to earn a reasonable return, or profit, on their rate base investment, in view of the level of risk involved. *Pennsylvania Power Company v. Pa. Publ. Util. Comm'n,* 561 A.2d 43, 47 (Pa. Cmwlth. Ct. 1989), 1989 LEXIS 434.

**2. Legal Standards Regarding Fair Rate of Return**

The law charges the Commission with the duty of protecting the rights of the public. *City of Pittsburgh v. Pa. PUC*, 126 A.2d 777, 785 (Pa. Super. 1956) (*City of Pittsburgh II*). As a general rule, a public utility, whose facilities and assets have been dedicated to public service, is entitled to *no more than* a reasonable opportunity to earn a fair rate of return on shareholder investment. Discussing rate of return, the *City of Pittsburgh II* court wrote that “[i]t is the function of the commission in fixing a fair rate of return to consider not only the interest of the utility but that of the general public as well. The commission stands between the public and the utility.” Id.

Along with other factors, cost of capital is a part of all ratemaking determinations. *Pa. PUC v. Philadelphia Suburban Water Co.*, 71 Pa. PUC 593, 623 (1989) (*PSW 1989*). The Commission has defined rate of return as:

[T]he amount of money a utility earns, over and above operating expenses, depreciation expense, and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the ‘return’ are interest on long-term debt, dividends on preferred stock, and earnings on common equity. In other words, the return is the money earned from operations which is available for distribution among the various classes of contributors of money capital.

*PSW 1989*, 71 Pa. PUC at 622-23, quoting *Public Utility Economics,* Garfield and Lovejoy, 116 (1964). Further, “[t]he return authorized must not be confiscatory, and must be based upon the evidence presented.” *PSW 1989*, 71 Pa. PUC at 623, *citing Pittsburgh v. Pa. PUC*, 165 Pa. Super. 519, 69 A.2d 844 (1949).

A public utility with facilities and assets used and useful in the public service is entitled to no more than a reasonable opportunity to earn a fair rate of return on its investment. The United States Supreme Court established the standard with which to evaluate whether a rate of return is fair in *Bluefield Waterworks & Improvement Co. v. Public Service Comm’n of West Virginia*, 262 U.S. 679 (1923) (*Bluefield*), stating:

The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management… to raise the money necessary for the proper discharge of public duties.

*Bluefield,* 262 U.S. at 693. The Court also said that allowed rates of return should reflect:

[A] return on the value of the [utility’s] property which it employs for the convenience of the public equal to that… being made at the same time… on investments in other business undertakings which are attended by corresponding risks and uncertainties.

*Bluefield*, 262 U.S. at 692. Twenty-one years later, the Court reviewed the issue of fair rate of return in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944) (Hope). In Hope, the Court held a fair rate of return “should be commensurate with returns on investments in other enterprises having corresponding risks” while being sufficient “to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.” *Hope,* 320 U.S. at 603. The Court noted that “[t]he rate-making process under the Act, i.e., the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and the consumer interests . . . and does not insure that the business shall produce net revenues.” *Id*. The Court has also stated that consumers are obliged to rely upon regulatory commissions to protect them from excessive rates and charges. *See Permian Basin Area Rate Cases*, 390 U.S. 747, 794-95 (1968) *citing Atlantic Refining Co. v. Public Service Comm’n*, 360 U.S. 378, 388 (1959).

Finally, in *Duquesne Light Co. v. Barasch*, the Court stated:

[W]hether a particular rate is ‘unjust’ or ‘unreasonable’ will depend to some extent on what is a fair rate of return given the risks under a particular rate setting system, and on the amount of capital upon which the investors are entitled to earn that return. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989). In determining a fair rate of return, this Commission has described its task as follows:

A fair rate of return for a public utility, however, is not a matter which is to be determined by the application of a mathematical formula. It requires the exercise of informed judgment based upon an evaluation of the particular facts presented in each proceeding. There is no one precise answer to the question as to what constitutes the proper rate of return. The interests of the Company and its investors are to be considered along with those of the customers, all to the end of assuring adequate service to the public at the least cost, while at the same time maintaining the financial integrity of the utility involved.

*Pa. PUC v. Pennsylvania Power Co.,* 55 Pa. PUC 552, 579 (1982). *See also Pa. PUC v. National Fuel Gas Dist. Corp*., 73 Pa. PUC 552, 603-605 (1990).

OCA MB at 33-34.

**3. Party positions**

As the Company states above, it seeks an 8.47% overall rate of return, including an 11.25% return on common equity. PPL Electric Stmt. 11, Exh PRM-1 at 1. This is based on its capital structure of 48.98% long-term debt and 51.02% common equity.



The Company modified its overall return to which reflects the actual issuance of $250 million of long-term debt on August 24, 2012 at an interest rate of 2.61%. This update for the actual issuance reduced the Company’s long-term debt cost to 5.50%, increased the long-term debt ratio to 49.22% and reduced the common equity ratio to 50.78%. PPL Electric MB at 91.



OCA states that this request is excessive and recommends a fair overall rate of return as no more than 7.19%, including a cost of common equity of 9.00%, and a proposed capital structure of 47.16% equity to 52.84% debt. OCA MB at 30.



I&E recommends 45% equity to 55% long term debt for a 6.84% overall rate of return and a 8.38% return on equity. I&E MB at 77.



The Company argues that the public advocates' recommendations rely on historically low interest rates instituted during the recent recession in an attempt to justify returns on common equity that are far below any allowed by this Commission in decades. Even in these difficult financial times, allowed ROEs have ranged between 9.75% and 10.99%. PPL Electric MB at 87-88; PPL Electric Stmt. 12-R at 3-5. The Company avers that if either of these is adopted, Pennsylvania utilities will be placed at a disadvantage compared to other utilities in the country in terms of raising capital during what it terms to be a critical infrastructure replacement phase, PPL Electric Stmt. 12-R at 3-5, as well as at risk for another downgrade in its credit rating.[[8]](#footnote-8) Of course, accompanying this would be higher debt costs and potential limits to access to capital in difficult markets. PPL Electric MB at 87-88.

**4. Capital Structure**

Capital structure means a determination of the appropriate proportions of debt and equity used to finance the rate base. A capital structure should be representative of the industry norm and be an efficient use of capital. The use of a capital structure that is significantly outside the range of the industry's capital structure may result in an overstated overall rate of return. I&E MB at 82. The first step is to determine if the actual capital structure of the Company is "significantly outside the range of the industry," in order to decide whether to use the actual structure or a hypothetical.

The Company points out that the legal standard in Pennsylvania for deciding whether to use a hypothetical capital structure in setting rates is simple and straightforward: if a utility's actual capital structure is within the range of a similarly situated barometer group of companies, rates are set based on the utility's actual capital structure. Only if the capital structure is atypical (outside of the range of the barometer group), should a hypothetical capital structure be used to set rates for a utility. PPL Electric RB at 41. *Pa. Publ. Util. Comm'n v. City of Lancaster – Water,* 197 PUR 4th 156, 161-162, Docket No. R-00984567 (Order entered September 22, 1999); *Pa. Publ. Util. Comm'n v. City of Bethlehem,*84 Pa PUC 275, 304 (1995); *Carnegie Natural Gas Co. v. Pa. Publ. Util. Comm'n,* 433 A.2d 938, 940 (Pa. Cmwlth. 1981)(where a utility's actual capital structure is too heavily weighted on either the debt of equity side, the Commission must make adjustments).

Both I&E and OCA seek to utilize a hypothetical capital structure in order to "drive PPL Electric's actual equity ratio down to the barometer group despite the fact that PPL Electric's actual equity ratio is within the range of the barometer group . . . ." PPL Electric RB at 41. The Company seeks to use its actual capital structure.

The three parties' barometer groups all contain comparison companies which are higher and lower than PPL Electric's capital structure in this case.

a. **Barometer Groups**

A barometer (or proxy) group is a group of companies that act as a benchmark for determining the utility’s rate of return. I&E MB at 79. I&E notes that a barometer group is necessary because PPL Electric is a private wholly owned subsidiary of PPL Corp and is not publicly traded. Using data from a group of companies is more reliable than data from a single company in that it smooths short-term anomalies and the use of a barometer group satisfies the long-established principle of utility regulation that seeks to provide the utility the opportunity to earn a return equal to that of similar companies. I&E MB 79 – 80.

PPL witness Paul Moul selected two barometer groups, an Electric Distribution Group (EDG) and an Integrated Electric Group (IEG). Mr. Moul’s EDG group was based upon the following criteria:

1. Their stock is traded on the New York Stock Exchange;

2. They are listed in the Electric Utility (East) section of *The Value Line Investment Survey*;

3. They are not currently the target of a publicly-announced merger or acquisition; and

4. They do not have a significant amount of electric generation.

PPL Witness Moul’s criteria for his IEG are identical except for criterion 4, which requires that at least 75% of the companies’ identifiable assets are subject to public regulation.[[9]](#footnote-9)

I&E uses a barometer group comprised of Consolidated Edison, Dominion Resources, Nextera Energy, TECO Energy, PEPCO Holdings, and UIL Holdings. I&E Stmt. 1 at 9-11. These were chosen based on the following criteria:

1. 50% or more of the company’s revenue were generated from the electric distribution industry;

2. The company’s stock was publicly traded;

3. Investment information for the company was available from more than one source;

4. The company was not currently involved/targeted in an announced merger or acquisition; and

5. The company had six consecutive years of historic earnings data.

I&E MB at 80.

The equity ratios for I&E's barometer group for 2011 range from 39.34% equity to 52.47% equity. I&E Exh. No. 1, Sch. 1 at 2. I&E witness Sears then averaged the companies in her barometer group and developed a hypothetical capital structure based upon the average of 54.89% long-term debt and 45.11% equity for the future test year, or 55% debt/45% equity. I&E MB at 82.

OCA witness Hill used sixteen companies that had at least 70% of revenues from electric operations, did not have a pending merger, did not have a recent dividend cut, had stable book values and a senior bond rating between "A" and "BBB-". He used "wires" companies as well as those with generation, and all were listed in *Value Line.* OCA Stmt. 2 at 29-30. The OCA methodology is explained in detail in OCA MB at 52-57.

I&E argues that PPL Witness Moul’s selected EDG and IEG barometer groups are flawed. Northeast Utilities must be excluded from his EDG and Duke must be excluded from his IEG because their inclusion violates the Company's own presumably objective criteria number 3 in that Northeast is the subject of an announced merger with NSTAR and Duke is the subject of an announced merger with Progress Energy. I&E MB at 81.

TECO Energy and Dominion Resources should be excluded from the Company's IEG and instead included in his EDG because they derive more than 50% of their revenues from their regulated electric distribution sector. However, I&E contends that the Company's IEG group should be disregarded in its entirety because the group is too dissimilar in terms of business lines to be comparable to PPL in this proceeding: PPL does not have regulated generation or *gas* distribution, properties common to SCANA Corp. and Southern Co. included in the IEG; and neither companies’ revenues are derived more than 50% from electric distribution only. I&E Stmt. 1 at 11-12.

I&E MB at 80-82.

However, PPL Electric points out that I&E's barometer group has equity ratios ranging from 39.34% to 52.47% equity, I&E Exh. No. 1, Sched. 1 at 2, and that the Company's actual equity ratios is 50.78% -- lower than two of the I&E barometer companies. This does not support a finding that the actual capital structure is atypical. PPL Electric RB 42. Similarly, OCA attempts to persuade the Commission that the Company's structure is atypical, but the cases cited for the statements can be easily distinguished on the facts. See PPL Electric RB at 43-46.

The Company actually issued $250 million of new debt at an interest rate of 2.61% on August 24, 2012. Reflecting these actual data reduces the weighted average long-term debt cost rate from 5.56% to 5.50%. It also increases the long-term debt ratio in the capital structure from 48.97% to 49.22%, and decreases the common equity ratio from 51.03% to 50.78%. The combination of these two adjustments reduces the Company's overall weighted cost of capital from 8.46% to 8.42%.

PPL Electric MB at 91, fn 16.

The law permits the use of a hypothetical when the Company's actual capital structure is atypical, not when it is inconvenient. I&E points out that PPL Electric's claimed capital structure, if left unadjusted, overstates PPL Electric's capital needs by $15 million. I&E MB at 83.

The appropriate capital structure is the Company's actual capital structure of 49.22% long-term debt and 50.78% common equity.

**5. Cost of Long-Term Debt**

I&E and OCA agree with PPL Electric that 5.50% is the appropriate cost of long-term debt for purposes of this proceeding[[10]](#footnote-10). This represents PPL’s expected cost of long-term debt and amortization of loss on reacquired debt for the FTY. I&E RB at 67. OCA RB at18 fn 4. PPL Electric MB at 91.

**6. Return on Common Equity**

**a. Introduction**

PPL Electric witness Moul, summarized his approach to determining the cost rate for common equity and the results of such analysis, as follows:

In general, the use of more than one method provides a superior foundation to arrive at the cost of equity. At any point in time, reliance on a single method can provide an incomplete measure of the cost of equity.

The specific application of these methods/models will be described later in

my testimony. The following table provides a summary of the indicated costs of equity using each of these approaches.

|  |  |  |
| --- | --- | --- |
|  | Electric Delivery         Group | Integrated Electric Group |
| DCF | 10.37 % | 10.87% |
| RP | 10.75% | 10.75% |
| CAPM | 11.78% | 12.48% |
| CE | 11.60% | 11.60% |
| Average  Median  Mid-point | 11.13% 11.18% 11.08% | 11.43% 11.24% 11.62% |

Based on these results, I recommend that the Commission set the Company’s rate of return on common equity at 11.25% in this case, which is between the average results for the Electric Delivery Group and the Integrated Electric Group. In recommending an 11.25% rate of return on common equity, I have recognized the exemplary performance of the Company’s management, as described in the pre-filed direct testimony of Mr. Gregory N. Dudkin, the Company’s President. I have done this by moving my recommendation above the average shown above for the Electric Delivery Group. I believe that my final recommended cost of equity of 11.25% is appropriate in this case because it is within the range of cost rates shown above and provides recognition of the excellent management performance of the company.

PPL Electric St. 11, pp. 5-6.

Mr. Moul elaborated on the reasons for using more than one model to determine the cost of equity:

It also is important to reiterate that no one method or model of the cost of equity can be applied in an isolated manner. As I noted previously, each of the methods used to measure the cost of equity has its own limitations that can cause the model to generate unrealistic results under certain circumstances. Therefore, I favor considering the results from a variety of methods. In this regard, I applied each of the methods with data taken from the Electric Delivery Group and the Integrated Electric Group and considering those results along with the other factors I have identified I have arrived at a cost of equity of 11.25% for PPL Electric.

PPL Electric St. 11, p. 41; PPL Electric MB at 104.

Both OCA and I&E argue that an 11.25% return on equity is excessive. OCA states that it would result in a shareholder windfall at the expense of ratepayers and would result in rates that are unjust and unreasonable. ". . . the current and near-term future economic outlook is one that includes a low cost of capital. OCA St. 2 at 11-19. The current economic conditions and outlook produce a favorable cost of equity environment for PPL." OCA MB at 47.

OCA cites numerous other jurisdictions which have awarded less than 10%, in particular, PEPCO:

We conclude that the 8.43% - 9.85% ROE range recommended by the other parties represents a reasonable range of potential returns for Pepco. In determining Pepco’s actual ROE within that range, we note that Pepco owns no generation, being only a distribution company, has no competition, and serves a heavily residential customer base. Its customer base is not subject to closing or wholesale relocation, thus significantly reducing the level of Pepco’s economic risk.

…

The final ROE of 9.31% recognizes the less risky nature of Pepco’s operations, is based on a wide and varied range of methodologies, and balances the interests of Pepco’s ratepayers and shareholders. The return Pepco’s investors will be allowed to earn in this case is appropriate, particularly under the present economic climate. We have no doubt that a monopoly company in a stable service territory with the potential of earning 9.31% on its equity will be able to attract the necessary capital in the current low interest rate environment to meet its statutory requirements to provide safe and reliable service to its customers.

*In re PEPCO,* Order No. 85028 (MD PSC, July 20, 2012) authorizing a 9.31% ROE at 108-109.

**b. PPL’s Proposed Return on Common Equity**

There are four methods used by PPL Electric’s witness Moul to determine the cost of equity: Discounted Cash Flow (DCF), Risk Premium (RP), Capital Asset Pricing Model (CAPM), and Comparable Earnings (CE):

**Discounted Cash Flow (DCF)**

OCA witness Hill describes the DCF as:

The Discounted Cash Flow (DCF) model relies on the equivalence of the market price of a stock (P) with the present value of the cash flows investors expect from the stock, and assumes the discount rate equals the cost of capital. The total return to the investor, which equals the required return and the cost of equity capital according to this theory, is the sum of the dividend yield and the expected growth rate in the dividend.

The theory is represented by the equation,

k=D/P + g

where “k” is the equity capitalization rate (cost of equity, required return), D/P is the dividend yield (dividend divided by the stock price) and “g” is the expected long-term sustainable growth rate. OCA St. 2, p. 26.

Witness Moul states that:

In its simplest form, the DCF return on common stock consists of a current cash (dividend) yield and future price appreciation (growth) of the investment. PPL Electric St. 11, p. 24.

The following table summarizes the parties’ findings based on the DCF methodology and the parties’ subsequent ROE recommendations:

|  |  |  |
| --- | --- | --- |
| **Party** | **DCF Results** | **Recommended ROE** |
| PPL | 9.68% | 11.25 % |
| OCA | 8.97% | 9.00% |
| OTS | 8.38% | 8.38% |

Source: OCA St. 2 at 4, 38, and 71; I&E St. 1 at 7 and I&E Exh. 1, Sch. 8.

PPL Electric’s witness Moul also added a leverage adjustment stating that a leverage adjustment is required when the results of the DCF model (k) are to be applied to a capital structure that is different than that which underlies the market price (P). PPL Electric stmt. 11 at 37. Witness Moul’s DCF adjusted barometer groups for leverage result in a DCF cost rate between 10.37% and 10.87%:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | Dividend | + | Growth | + | Leverage | = | DCF Cost Rate |
| Electric Delivery Group | 4.67% |  | 5.00% |  | 0.70% |  | 10.37% |
| Integrated Electric Group | 4.69% |  | 5.00% |  | 1.18% |  | 10.87% |

PPL Electric Stmt. 11 at 41.

The OCA’s recommended 9.0% ROE is based on the adoption of the OCA’s recommended capital structure in this case, as discussed in detail above. As Mr. Hill explained in his direct testimony:

However, if the Commission elects to utilize the Company’s requested ratemaking capital structure, which would contain approximately 51% common equity, that would impart significantly lower financial risk than that of the average capital structure of the similar-risk sample groups. In that case an equity

return at the lower end of the current cost of equity range, 8.75%, would be reasonable.

OCA St. 2 at 53.

OCA MB at 49.

I&E recommends a cost of common equity of 8.38%. Witness Sears’ analysis uses a spot dividend yield and a 52-week dividend yield, and a combination of earnings growth forecasts and a log-linear regression analysis growth rate. Using the standard DCF model formula,[[11]](#footnote-11) she recommends a dividend yield of 4.89% and her recommended growth rate of 3.49%. Witness Sears calculates an appropriate return on common equity for PPL to be 8.38%.

I&E MB at 86.

**i. Dividend yields**

PPL Electric witness Moul derived the dividend yield by calculating the six month average dividend yields for each group and adjusting those yields for expected growth in the following year to produce the 4.67% for the Electric Delivery Group and 4.69% for the Integrated Electric Group. PPL Electric St. 11, p. 26; PPL Electric MB at 104.

Mr. Moul proposes an ex-dividend adjustment to the dividend yields of his barometer group by adjusting the “month-end prices to reflect the buildup of the dividend in the price that has occurred since the last ex-dividend date.”[[12]](#footnote-12) The ex-dividend adjustment as proposed by Mr. Moul is inappropriate because it is unsupported in academic literature, there is no evidence that investors make this adjustment in the context of the DCF model, and financial publications do not provide ex-dividend adjusted yields to investors that might be used for their financial investment decision making. If such information were an important factor in an investor’s decision-making process, main stream financial publications would regularly include it. That they do not is indicative of the lack of support for Mr. Moul’s adjustment.[[13]](#footnote-13) Before adjustment, Mr. Moul uses a dividend yield of 4.54% for his EDG and 4.56% for his IEG, both before adjustments.[[14]](#footnote-14)

I&E MB at 93.

I&E states that a representative yield must be calculated over a time frame sufficient to avoid short-term anomalies and state data. I&E witness Sears’ dividend yield calculation places equal emphasis on the most recent spot (4.78%) and 52-week average (5%) dividend yields resulting in an average dividend yield of 4.89%.[[15]](#footnote-15) I&E MB at 86.

OCA witness Hill employed a 4.44% DCF adjusted yield, based upon the average dividend yield of his proxy group of similar companies. OCA St. 2 at 38; OCA MB at 55.

For the reasons set forth by I&E, I recommend the I&E proxy group and methodology for determining the 4.89% dividend yield.

**ii. Growth rates**

PPL witness Moul reviewed various methods of calculating investor expected growth rates and concluded that analysts’ projections of growth rates are the best indicator of expected growth. PPL Electric St. 11, p. 34. The Company avers that this conclusion is supported by the research of Myron Gordon, the foremost proponent of the use of DCF in utility rate proceedings. *Id.*, p. 34. The range of such growth rates was 4.50% to 5.08% for the Electric Delivery Group and 4.59% to 6.00% for the Integrated Group. Mr. Moul chose a growth rate of 5.00% for both groups. PPL Electric MB at 105.

PPL witness Moul employed a growth rate of 5% based upon an average EDG growth rate of 4.87% and an average IEG growth rate of 5.14%. However, because Mr. Moul’s growth rate is developed from his flawed barometer groups, his growth rates are overstated. As stated above, Mr. Moul’s EDG contains two companies that are the subject of announced mergers. Because announced mergers typically affect analysts’ forecasts, use of those companies in the EDG overstates the DCF analysis. Further, the IEG includes companies that are not similar in business risk to PPL. Again, such dissimilarity can overstate growth rates, thus overstating Mr. Moul’s DCF analysis.

I&E St. 1 at 39-40; I&E MB at 93.

I&E witness Sears used both earnings growth forecasts and a log-linear regression analysis data to calculate her expected growth rate. Her earnings forecasts are developed from projected growth rates using 5-year estimates from established forecasting entities for her barometer group of companies, yielding an average 5-year growth forecast of 4.79%. I&E St. 1 at 25-26

I&E witness Sears avers that investor forecasts may be biased and/or distorted by misestimates, and therefore, Ms. Sears used a log-linear regression analysis to determine a more appropriate long term growth rate. Ms. Sears’ log-linear regression analysis used historic earnings per share (EPS) from *Value Line* for the years 2006-2011, and financial analysts forecasted growth rate to project EPS values for the FTY (2012) through 2016. The result of her log-linear regression analysis provided an average growth rate of 3.49%. I&E St. 1 at 25-30; I&E MB at 86-86.

PPL witness Moul notes that Ms. Sears growth rate is the result of her log linear analysis and not the result of analysts’ projections. He notes that:

Ms. Sears simply converts analysts’ projections to a lower growth rate through her log linear analysis. Mr. Moul demonstrates that Ms. Sears in fact reduced the analysts’ 4.79% projections of growth to 3.49%, or by 130 bases points or by 27% (1.3/4.79) through her log linear analysis. PPL Electric St. 11-R, p.23. Furthermore, the record demonstrates that there is no basis for Ms. Sears’ log linear growth rate calculation, and Ms. Sears could not identify any analyst or publication that used it to project growth rates to be used in a DCF analysis. PPL Electric St. 12-R, pp. 23-24; Tr. 350.

PPL Electric RB at 59.

OCA witness Hill's analysis is described as follows:

As shown on page 2 of Schedule 4, my DCF growth rate estimate for all the electric utility companies included in my analysis is 4.94%. This figure exceeds Value Line’s projected average growth rate in earnings, dividends and book value for those same companies (4.48%) and is also above the five-year historical average earnings, dividend and book value growth rate reported by Value Line for those companies (4.74%). My growth rate estimate for the electric companies under review is above the IBES analysts’ earnings growth rate projections—4.39%, and above the average earnings growth estimate of those polled by Zack’s (4.5%). Also, my growth rate estimate is well above the projected dividend growth rate of the sample companies, 3.72%. Therefore, my average DCF growth rate is similar to the growth rate data available to investors and provides a reliable assessment of investors’ long-term sustainable growth rate expectations for the companies under review.

OCA St. 2 at 33[[16]](#footnote-16); OCA MB at 54-55.

I recommend using the 4.79% growth rate of I&E without the log-linear analysis.

**iii**. **Leverage Adjustment**

The Company promotes a leverage adjustment in this matter, which it explains as follows:

The leverage adjustment is designed to adjust the DCF cost rate for the different percentage level of debt in the capital structure when capital structure is calculated at the market prices of equity and debt securities as opposed to book value. For example, a utility that has a stock price above book value has a market value or capitalization of its equity that is greater than the book value of its equity. When an investor purchases that equity at the market price, the percentage of equity in the market capitalization is greater than the percentage of equity at book value. Under such circumstances, the DCF cost rate based on market prices must be adjusted to reflect the greater financial risk to investors when that cost rate is applied to a book value rate base in utility proceedings.

PPL Electric MB at 105.

There is precedent for the use of leverage adjustment. *Pa. P.U.C. v. PPL Electric Utilities Corp.,* (Dec. 6, 2004), Docket No. R-00049255, *Pa. P.U.C. v. PPL Gas Utilities Corp.,* (Feb.  8, 2007) at R-00061398 (Feb. 8, 2007). The Commonwealth Court has held that the decision of whether to adopt a leverage adjustment is within the Commission’s discretion.

*Popowsky v. Pa. P.U.C.*, 868 A.2d 606 (Pa. Cmwlth Ct.).

The Company explains that financial leverage is the use of debt capital to supplement equity capital. A firm with significantly more debt than equity is considered highly leveraged. Generally, a market-to-book ratio is used to evaluate a public firm’s equity value. This is done by comparing a company’s equity market value to a company’s equity book value. I&E Stmt. 1 at 42-43.

PPL Electric witness Moul proposes a 70 basis point leverage adjustment to his EDG and a 118 basis point leverage adjustment to his IEG. Mr. Moul theorizes that if regulators use the results of the DCF to compute the weighted average cost of capital based on a book value capital structure used for ratemaking purposes, the utility will not, by definition, recover its risk-adjusted capital cost. Mr. Moul believes this is because market valuations of equity are based on market value capital structures, which in general have more equity, less debt and, therefore, less risk than the capitalization measured at its book value. PPL Electric Stmt. 11 at 35.

The Company points out that the Commission has accepted the leverage adjustment in a number of cases, including PPL Electric’s last fully litigated rate case in 2004. *Pa. P.U.C. v. Pa. American Water Co.*, (Jan. 10, 2012), Docket No. R-0001639 (60 basis point adjustment); *Pa. P.U.C. v. Philadelphia Suburban Water Company,* (Aug. 1, 2002), Docket No. R-00016750, 80 basis points; *Pa. P.U.C. v. Pa. American Water Co.*, (Nov. 8, 2004), Docket No. R-00038304, 60 basis points, affirmed. *Popowsky v. Pa. P.U.C.*, 868 A.2d 606 (Pa. Cmwlth. 2004); *Pa. P.U.C. v. Aqua Pa. Inc,* (Aug. 5, 2004), Docket No. R-00038805, 60 basis point adjustment; *Pa. P.U.C. v. PPL Electric Utilities Corp.,* (Dec. 22, 2004), Docket No. R-00049255, 45 basis point adjustment; *Pa. P.U.C. v. PPL Gas Utilities Corp.,* (Feb. 8, 2007), Docket No. R-00061398, 70 basis points.

The Company seeks to distinguish *Pa. P.U.C. v. Aqua Pa. Inc.,* (July 17, 2008), Docket No. R-00072711, (“*Aqua 2008*”), where the Commission declined to use a leverage adjustment in arriving at the DCF cost of equity, stating as follows:

Based upon our analysis and review of the record, the Recommended Decision, and the Exceptions and Replies thereto, we reject the ALJ’s recommendation to add a 65 basis point risk adjustment. The award of such an adjustment is not precedential but discretionary with the Commission. In fact, in *Met Ed/Penelec* (*Pa. P.U.C. v. Metropolitan Edison Co./Pennsylvania Electric Co.* Order of Jan. 11, 2007, at R-000161366 and R-00061367), we specifically approved the removal of any risk adders from the cost of equity calculations. *Met Ed/Penelec* at 136.

In the cases cited by Aqua in support of its leverage adjustment, it is obvious that the DCF results in those cases were not as high as the unadjusted DCF result we have in this proceeding, since the final cost of equity in those cases was no higher than 10.6% with the leverage adjustment. The unadjusted DCF results presented by the Parties in this case are generally higher than the DCF recommendations from the earlier cases cited by Aqua. When viewed in the context of the other methodologies, we conclude that there is no need to have an upwards adjustment to compensate for any perceived risk related to Aqua’s market-to-book ratio. Accordingly, we reject the ALJ’s recommendation to allow a 65 basis point leverage adjustment.

*Id.*, pp. 38-39, (*Aqua 2008*)(The Commission concluded that the cost of equity was 11.0% applied to a 50.9% common equity ratio.)

The Commission has applied the leverage adjustment in cases where it believes market conditions have resulted in a DCF cost rate that is understated. PPL Electric argues that the DCF cost rate is understated in the present case, and cites the DCF result for PPL Electric witness Moul’s Electric Delivery Group, which would be 9.67% without the leverage adjustment and 9.69% for the Integrated Electric Group.

PPL Witness Moul testified that use of the DCF alone, and without consideration of the leverage adjustment, significantly understates the cost of equity. When investors expectation of future earnings are pessimistic due to factors including future regulatory allowances, there is the potential for the DCF to be circular and not market based. PPL Electric Stmt. 11 at 24; PPL Electric MB at 108.

OCA recommends against the Company's leverage adjustment because there is no evidence to support a risk difference between a market-based capital structure and a book value capital structure. Rather, the claim that the DCF results should be increased by 70-118 basis points due to PPL Electric witness Moul's leverage adjustment is "not sound ratemaking." OCA MB at 60.

I&E witness Sears argues that rating agencies assess financial risk based upon the company’s booked debt obligations and the ability of its cash flow to cover the interest payments on those obligations by using financial statements, particularly income statements, for their analyses, not market capitalization.

I&E points out that, while the Commission has granted this adjustment on occasion, it has also rejected it:

In a Blue Mountain Water Company case on remand from Commonwealth Court to clarify findings concerning fair rate of return, the Commission identified seven principles that were applied to analyze the company’s required and lawful rate of return. The Commission’s third identified principle stated that “[m]arket price-book value ratios are not a goal of regulation but a result of regulation, general economic factors and individual company’s characteristics of management, operations and perceived future. *In general, we view a market-book ratio in the area of one-to-one as appropriate for regulated industry*.”[[17]](#footnote-17)

In a 2008 case involving Aqua Pennsylvania, Inc., the Commission rejected the ALJ’s recommendation for a leverage adjustment stating, “the fact that we have granted leverage adjustments in the past does not mean that such adjustments are indicated in all cases.”[[18]](#footnote-18) In a 2007 Metropolitan Edison Company case, the Commission rejected the Company’s financial risk increment related to the leverage difference between market capital structures and book value capital structures.[[19]](#footnote-19) Most recently in a City of Lancaster case, the Commission agreed with Ms. Sears’ recommendation to reject the leverage adjustment, stating “any adjustment to the results of the market based DCF as we have previously adopted are unnecessary and will harm ratepayers. Consistent with our determination in *Aqua 2008* there is no need to add a leverage adjustment.”[[20]](#footnote-20)

I&E MB at 73-74.

I&E calculates that there are six cases in which the Commission accepted the leverage adjustment, most recently in 2007. The adjustment has been proposed in 68 cases over a 23 year period yielding 6 successful results. Finally, I&E charges that Mr. Moul’s formulae for the adjustment are flawed as he uses formulae which do not appear in the research cited to support it. I&E MB at 100.

I&E argues that investor information also supports rejection of Mr. Moul’s leverage adjustment:

A *Value Line Investment Survey* for Mr. Moul’s EDG showing the market and book values of debt and equity assigns the book valued capital structure percentages and the book value of debt at the end of 2010. While Mr. Moul testifies that the market return is based upon market valued capital structures, this investment information proves this to be untrue for the regulated utility industry. Thus, investors base their decisions, and therefore their required market return, on the *book* values, not the *market* values. No leverage adjustment is needed or supported. I&E St. 1 at 52; I&E Ex. 1, Sch. 14 at 2.

I&E MB at 95-101.

The OCA submits that no ROE-enhancing adder is needed or appropriate for PPL based on the facts of this matter. As OCA witness Hill testified:

While there are certainly many aspects of rate of return analysis that are subject to judgment and, thus, debate regarding the proper application of a particular technique, Mr. Moul’s use of an imaginary risk difference between a market-based capital structure and a book value capital structure is not one of them. There is no evidence available in the literature of financial economics to support any risk difference between market-value and book-value capital structures. Miller and Modigliani (supposedly the source of Mr. Moul’s “leverage” adjustment) do *not* compare market-value and book value capital structures.

OCA St. 2-SR at 4. (Emphasis in original). Mr. Hill provided support for his 9.00% cost of equity recommendation primarily based on the DCF model, including a full range of indicators of dividend yields and growth rates intended to reflect what investors actually use and consider. The Company’s claim that Mr. Moul’s DCF results should be increased by anywhere from 70-118 basis points due to his leverage adjustment, is not sound ratemaking. *See* PPL St. 11 at 41. The 9.00% cost of equity recommended by Mr. Hill is appropriate and reasonable to determine an appropriate rate of return for PPL.

PPL witness Moul testified that when utility market prices exceed book values, a risk difference exists between market-value capital structures and book-value capital structures, and market-based cost of equity estimates should therefore be adjusted upwards to account for that risk difference. This is the basis for Mr. Moul’s “leverage adjustment.” OCA Stmt. 2 at 55-56. OCA witness Hill testified as to the flawed nature of this theory, in relevant part:

There simply is no difference in financial risk when the market-value capital structure of a firm is different from the book-value capital structure. Financial risk is a function of the interest payments on the debt issued by the firm. That is, a firm’s debt payments create financial risk and when the amount of debt used to finance plant investment increases relative to common equity the financial risk increases. Whether the capital structure is measured with market values or book values, the debt interest payments do not change and, therefore, financial risk does not change. As a result, market-value capital structures are useful as indicators of financial risk only when they are compared with other market-value capital structures (as Miller and Modigliani do in their treatise), and Mr. Moul’s mixed-metaphor comparison of market-value and book-value capital structures has no economic meaning.

OCA Stmt. 2 at 56. As Mr. Hill further explained:

The Company is making an improper comparison between market value capital structures and book value capital structures in order to claim that a financial risk difference exists. When utility common equity market prices are above book value, the capital structure measured with market values will have a higher equity percentage and lower debt percentages than the capital structure measured with book value. That does not mean, as the Company claims, that those different capital structure measures signify any difference whatsoever in financial risk.

OCA Stmt. 2 at 61.

The OCA acknowledges that in some cases the Commission made an adjustment to a DCF based cost of equity such as that proposed by Mr. Moul. More recently, however, the Commission has not adopted Mr. Moul’s leverage adjustment, as Mr. Hill testified:

[I]t is important to note that this Commission has rejected “financial risk adders” in Docket No. R-00061366 (Metropolitan Edison (Met Ed), Pennsylvania Electric, Opinion and Order, January 11, 2007, p. 136). The “financial risk adders” in the Met Ed case were based on the leverage/risk difference between market-value capital structures and book value capital structures, just as Mr. Moul’s are. In addition, in Docket No. R-00072711, Aqua Pennsylvania, Inc., July 17, 2008, at pages 35 through 39, this Commission specifically rejected Mr. Moul’s leverage/risk analysis—the same leverage/financial risk adjustment Mr. Moul uses in his testimony in this proceeding.

OCA Stmt. 2 at 57. OCA argues that other state commissions have uniformly recognized this type of adjustment as unwarranted in their decisions. *West Virginia Public Service Comm’n v. West Virginia-American Water Works*, 2004 W. Va. PUC LEXIS 6, 18 (2004). In addition to the West Virginia PSC, other Commissions have rejected similar market-to-book adjustments to the DCF model. The District of Columbia Public Service Commission rejected a company’s arguments that an adjustment to the DCF was appropriate to meet investors’ requirements. *In the Matter of the Application of Washington Gas Light Company, District of Columbia Division, for Authority to Increase Existing Rates and Charges for Gas Service,* 2003 D.C. PUC LEXIS 220, 72 (2003); *In the Matter of St. Louis, Missouri, for Authority to File Tariffs to Increase Water Service Provided to Customers in the Missouri Service Area of the Company*, 1998 Mo. PSC LEXIS 13, 17 (1988). *See gen’ly In the Matter of the Application of Wisconsin Electric Power Company for Authority to Increase its Rates for the Sale of Electricity in Michigan*, 2002 Mich. PSC LEXIS 294, 37-38 (2002).

At page 11 of his surrebuttal testimony in this proceeding, Mr. Hill summarized the reasons this Commission should reject Mr. Moul’s “fictional leverage” adjustment:

* The comparison of market value capital structures and book value capital structure to measure financial risk differences, is not supported in the literature of finance;
* There is no financial risk difference between market value and book value capital structures because interest expense (the actual source of financial risk) doesn’t change, regardless of the capital structure measurement perspective;
* One company cannot have two levels of financial risk (i.e., one based on book value and one based on market value);
* The DCF model does not “mis-specify” the cost of equity when market prices are different from book value, and utilities are able to attract capital on reasonable terms absent any so-called “leverage” adjustment;
* Moul’s “leverage” adjustment is, fundamentally, a market-to-book ratio adjustment, and this Commission has rejected market-to-book ratio adjustments in the past;
* The “leverage” adjustment is based on the “fair value” of the capital employed in financing the utility operation, as such it is a surrogate for “fair value” rate base, which results in a revenue requirement higher than that required by law in a regulatory jurisdiction in which rates are to be based on original cost (depreciated book value);
* A utility market price significantly above book value indicates that investors expect that firm to earn a return above its cost of equity, but according to Mr. Moul’s “leverage” adjustment the higher the market price, the greater the upward adjustment necessary, which would exacerbate the over-recovery;
* The “leverage” adjustment recommended by Mr. Moul has been presented in dozens of regulatory jurisdictions. It has been rejected by all of those jurisdictions (including, recently, Pennsylvania).

OCA St. 2-SR at 11. The OCA submits that for the reasons just discussed, and taking the record as a whole, such an adjustment should not be considered in this matter.

OCA MB at 60-64.

For the reasons developed by the OCA and I&E, the Company's leverage adjustment should be denied.

**Risk Premium**

PPL Electric argues that a risk premium applies in this case, based upon the basic financial tenet that an equity investor in a company has greater risk than a bond holder in a company because all interest on bonds is paid before any return is received by the equity investor and upon bankruptcy or dissolving a company the bond holder receives his capital before any capital is provided to the equity investors. PPL Electric St. 11, p. 44, and Appendix G, p. G-2. PPL Electric MB at 109.

The Risk Premium has common sense appeal to investors, who would expect to earn equity returns in excess of bond returns, as has been the case for any extended period in the capital markets. Accordingly, the Company explains the Risk Premium method as determining the cost of equity by summing the expected public utility bond yield and the return of equities over bond returns (the “equity premium”) over an historic period, as adjusted to reflect lower risk of utilities compared to the common equity of all corporations. PPL Electric St. 11, pp. 49-50.

The Company witness determined the risk premium cost of equity to be 10.75% as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Interest Rate | Risk Premium |  | Cost Rate |
|  | 5.25% | 5.50% | = | 10.75% |

The interest rate used for this calculation is an estimated interest rate for A-rated public utility bonds. PPL Electric St. 11, pp. 45-46. The risk premium is the average of actual premium earned by stocks over bonds over recent periods of 1974 – 2007 and 1979 – 2007, reflecting periods of modern financial circumstances, to produce an unadjusted premium of 6.22%. This historic premium was then adjusted to produce a premium of 5.50%.[[21]](#footnote-21) PPL Electric St. 11, pp. 49-50.

It is to be noted that the risk premium analysis produces a likely low estimate of the cost of equity for PPL Electric because PPL Electric’s bond rating is lower than the A-rating used in this analysis indicating greater risk and cost for PPL Electric. PPL Electric’s rating is also somewhat lower than the ratings for the Electric Delivery Group. PPL Electric St. 11, p. 13.

PPL Electric MB at 110.

I&E witness Sears recommends against using the risk premium and avers that it cannot be used because it relies on historic risk premiums achieved over bond yields which may not be applicable for the future. I&E St. 1, p. 19. The Risk Premium method has been relied upon by the Commission in the past to check the reasonableness of the DCF model.

In PPL Electric’s 2004 base rate proceeding, the Commission held as follows:

As noted previously, we have primarily relied upon the DCF methodology in arriving at our determination of the proper cost of common equity. The ALJ interpreted our previous actions in *PA WC* and *Aqua* as not compelling the use of other methods such as RP and CAPM to form an equity return based on a composite of the DCF and other methods. We agree with the ALJ insofar as these prior actions do not compel the use of methods in addition to the DCF method. However, we conclude that methods other than the DCF can be used as a check upon the reasonableness of the DCF derived equity return calculation. We note that all of the parties in this proceeding with the exception of the OTS have done so. We will also use the results of the CAPM and RP methods as a check of the reasonableness of our DCF calculation.

**• • •**

Those returns indicated by alternative, standard cost-estimation techniques provide additional measures so as to test the reasonable of our DCF based cost of equity capital rate of 10.70% (10.25 + .45 for financial risk). The PPL CAPM study produces a 10.70% return rate for its Electric Company Proxy Group. A USDOD CAPM study estimates an appropriate equity return of 11.00% [\*103] The USDOD risk premium result is 10.44%. The OCA estimates a CAPM rate range of 9.0 to 10.0%. Additionally, a Risk Premium analysis that indicates an appropriate return on equity for its electric proxy group of 11.75%.

*Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-00049255, pp. 67 and 72 (Dec. 22, 2007).

Based on the testimony of I&E witness Sears, reliance on the risk premium method is denied.

**Capital Asset Pricing Model (CAPM)**

The CAPM analysis determines a “risk-free” interest rate based on U.S. Treasury obligations and an equity risk premium that is proportional to the systematic (i.e., beta) risk of a stock, which are combined to produce cost rate of equity. PPL Electric St. 11, pp. 50-52. PPL Electric witness Moul also performed a CAPM analysis to estimate the cost of equity for the Electric Delivery Group and Integrated Electric Group and determined the risk free rate to be 3.75% based on current and near term project yields on long term treasury bonds. PPL Electric St. 11, pp. 53-54.

Mr. Moul determined the market or equity premium to be 8.76% premium based upon an average of historic and projected market premiums. PPL Electric St. 11, p. 54 and Appendix H, pp. H-4 to H-6. Betas are applied to the market premiums to adjust for electric company risks relative to the total market and the betas are adjusted for the same reasons as the leverage adjustment to the DCF. PPL Electric St. 11, pp. 52-53. Finally, a size adjustment to reflect greater risk for smaller firms relative to the market. PPL Electric St. 11, pp. 54-55. The results of the CAPM analysis are 11.78% for the Electric Delivery Group and 12.48% for the Integrated Electric Group.

The results of the CAPM analysis indicate the upper range of the cost of equity analysis using the theoretical models typically employed in utility rate cases.

PPL Electric MB at 113.

I&E witness Sears also performed an analysis of a return on equity using the CAPM methodology:

For her CAPM analysis, Ms. Sears chose the risk-free rate of return (Rf) from the projected yield on 10-year Treasury Bonds as the most stable risk-free measure. With this choice, Ms. Sears balanced out issues related to use of long term bonds and short term T-Bills. For her Beta, Ms. Sears used the average of the betas from *Value Line.* To arrive at a representative expected return on the overall stock market, Ms. Sears surveyed *Value Line*, *Morningstar*, and the S&P 500 Index. For the S&P returns, Ms. Sears selected five different time periods ranging from 5 to 86 years in order to represent a variety of investor experiences and time horizons. The results of these two overall stock market returns based on Ms. Sears’ forecasted and historic CAPM analyses are 16.02% and 6.02%, respectively. These, in turn, yield cost of equity results under the forecasted and historic analyses of 12.31% and 5.06%, respectively.

I&E witness Sears gave no specific weight to her CAPM results because of her concerns that unlike the DCF, which measures the cost of equity directly by measuring the discounted present value of future cash flows, the CAPM measures the cost of equity indirectly and can be manipulated by the time period used. However, having presented two analyses – historic and forecasted – both of which are comprehensive in the time periods covered, I&E submits that for purposes of providing another point of comparison, the 8.68% simple average of those two analyses confirms the reasonableness of Ms. Sears’ 8.38% return under her DCF calculation.[[22]](#footnote-22)

I&E MB at 88-89.

OCA’s witness Hill chose a risk free rate based on the long-term trend for Treasury Bonds, which he determined to be 4% for a forward looking CAPM analysis. Based on historical Morningstar data which shows an 11.8% return on stocks and a 5.8% return on long-term Treasury bonds since 1926, Mr. Hill determined a risk premium of 6%; yielding an overall expected stock market return of 10% (4% +6%). Mr. Hill determined his beta of 0.69 based on *Value Line* beta coefficients for his electric group. Based on this analysis, Mr. Hill’s CAPM analysis yields a cost of equity of 8.14% (4%+(0.69\*6%)). OCA St. 2, pp. 41-44.

Both Mr. Hill and Ms. Sears used a CAPM as a check of reasonableness for their DCF calculations. However, both also believe there are shortcomings to this model, express concerns regarding its use and note their preference for using the DCF model to determine the cost of equity capital. I&E MB at 85. OCA St. 2 p. 39.

**Comparable Earnings (CE)**

PPL Electric witness Moul also performed a comparable earnings analysis. Mr. Moul notes that because regulation is a substitute for competitively determined prices, returns realized by non-regulated firms with similar risks can be used as a guide to determine a fair rate of return. PPL Electric St., p. 56. Based on his analysis, his comparable earnings group yielded a historical return of 10.9%, a forecasted return of 12.3%, which resulted in an average return of 11.6%.

OCA witness Hill and I&E witness Sears did not perform a comparable earnings analysis. Ms. Sears notes:

The CE methodology is subjective in terms of the selection of comparable companies, has generally been rejected by the Commission, and, in Mr. Moul’s particular analysis, compares projected returns of companies of dissimilar business and financial risks.[[23]](#footnote-23) I&E MB at 92.

**c. Additional Risk Considerations**

**PPL’s Risk Assessment**

I&E charges thatMr. Moul’s rate of return recommendations are also grossly overstated by his assignment of several faulty assumptions of risk to PPL. Mr. Moul proposes a 120 basis point upward adjustment because he believes that as the size of a firm decreases, its risk and, hence, its required return, increases. Further, Mr. Moul uses the SBBI Yearbook to argue that the returns for stocks in lower deciles had returns in excess of those shown by the simple CAPM. PPL Stmt. 11 at 54-55. I&E disagrees:

While some technical market literature supports adjustments relating to a company’s size, in a critical point of distinction, this literature is *not* specific to the utility industry. On the other hand, utility-specific academic literature specifically argues against a size adjustment for utilities. A specific study of utility stocks and the size effect concluded as follows:

The objective of this study is to examine if the size effect exists in the utility industry. After controlling for equity values, there is some weak evidence that firm size is a missing factor from the CAPM for the industrial but not for utility stocks. This implies that although the size phenomenon has been strongly documented for the industrials, the findings suggest that *there is no need to adjust for the firm size in utility rate regulation*.[[24]](#footnote-24)

As to unpredictability, "one cannot expect risky companies to always outperform less risky companies; otherwise they would not be risky." I&E MB at 101-103.

Mr. Moul’s proposed size adjustment is denied.

**Utility Risk Analysis**

I&E submits that PPL witness Moul has grossly overstated the business risk faced by PPL specifically and the electric distribution industry generally, further contributing to his gross overstatement of the appropriate cost rate for PPL’s equity capital.

PPL witness Moul identifies the primary risk factors PPL faces as regulation, which diminishes management’s ability to adjust its business strategy quickly; a potential for bypass; the potential for financial penalties associated with operation problems; and growth in the utilization of the transmission and distribution network by non-affiliated generators and marketers.[[25]](#footnote-25) Mr. Moul’s statements, however, lack support and directly result in an overstatement of his equity cost recommendation.

Mr. Moul stated he could provide no evidence that PPL has paid any financial penalties, which he defines as foregone revenues, regulatory disallowance, and additional expenses. He admitted that he had no access to and reviewed no data specific to PPL, and that in addition to this purported risk not applying to PPL in particular, it did not even apply to the electric utility industry in general.[[26]](#footnote-26)

With respect to the purported risk of growth in transmission and distribution network bypass, despite the experience of over a decade of competition and Mr. Moul’s admission that he expressed this same concern in 2010, there is no evidence that PPL is experiencing this risk. According to current data provided by PPL, the Company has over 18 non-affiliated generators interconnected with its transmission network, and approximately 2,400 non-affiliated generators connected to its distribution network, yet *none* of these parties serves other customers or potential customers of PPL.[[27]](#footnote-27) Mr. Moul’s concerns are unsupported and gross exaggerations that cannot be relied upon.

Mr. Moul also grossly underestimates the mitigation of risk that accompanies the legislative introduction of the Distribution System Improvement Charge (DSIC) for PPL. Mr. Moul ignores the fact that PPL first sought approval of a DSIC in 2004 on the basis that it would “facilitate” the Company’s investment.[[28]](#footnote-28) Mr. Moul believes the DSIC will have “no impact” on the rates set in this proceeding because the DSIC will not be effective until 2013, and because the DSIC is subject to a variety of limitations including a cap on the amount of revenues that can be collected. He also notes that the Commission has never adjusted a water utility’s return for the existence of a DSIC.[[29]](#footnote-29)

While it is true that the DSIC will not become effective until 2013 and is subject to limitations as to plant and revenues, Mr. Moul’s failure to recognize *any* effect on risk factors prospectively and thereby appropriately determine the equity cost rate to allow in this proceeding overstates the risk PPL faces prospectively, and, consequently, the equity return Mr. Moul recommends. Rate of return is forward looking. PPL will file in *this future test year* the infrastructure improvement plan that is a necessary precursor to effectuation of the DSIC in 2013.[[30]](#footnote-30) Clearly, filing for the DSIC will timely follow. Consequently, if not appropriate actually to reflect PPL’s lower risk as a result of PPL’s highly anticipated implementation of the DSIC, it is certainly entirely inappropriate to continue to inflate PPL’s risk, as Mr. Moul does, in light of PPL’s ultimate legislative success in attaining that alternative ratemaking mechanism.[[31]](#footnote-31)

The fact that PPL’s own parent, PPL Corp., views passage of the DSIC as a positive investment risk development is well-documented on this record.[[32]](#footnote-32) In its investor presentations from late 2011 through early 2012, PPL Corp. closely tracked and reported on the status of the DSIC legislation in Pennsylvania. Almost monthly PPL Corp. reported on the movement of the DSIC legislation from the House Consumer Affairs Committee[[33]](#footnote-33) to passage by the full House of Representatives, to review by the Senate Consumer Protection and Professional Licensure Committee, to passage by the full General Assembly and ultimately approval by the Governor.[[34]](#footnote-34)

Yet, despite the parent company’s complete embrace of the positive impact on the investor community resulting from the DSIC, Mr. Moul not only completely ignores it in his evaluation of PPL’s risk, he continues to assert PPL specifically, and the EDC community in general, face such risk as to warrant a higher cost of equity. I&E submits that the behavior of PPL’s own parent more accurately reflects the anticipated impact the DSIC will have on PPL’s investment risk, and that such behavior directly proves the flaw of Mr. Moul’s exclusion of consideration of the DSIC in developing his recommendations in this proceeding. Thus, again, Mr. Moul overstates PPL’s risk and thereby overstates his recommended cost of equity.

While the Commission may not have adjusted water equity returns downward because of the existence of a DSIC, at a minimum Act 11 of 2012 should offset Mr. Moul’s concerns of increased risk due to the increased capital needed for infrastructure improvements. The existence of the DSIC will also allow PPL to be similar in risk to the EDG in its ability to collect its infrastructure needs on a current basis rather than on a deferred basis including a return on equity. If there is no need to *decrease* the rate of return for the existence of a DSIC, there certainly is no need to *increase* the rate of return for the increased infrastructure needs, the costs of which will be recovered on a timely basis by the DSIC.[[35]](#footnote-35)

I&E MB at 103-107.

**d. Management Effectiveness Adjustment**

The Commission's setting of rates includes a performance factor and requires consideration of efficiency, effectiveness and adequacy of service, as well as management effectiveness and operating efficiency **as measured by an audit pursuant to section 516** to the extent that the audit has been properly introduced by a party into the record. 66 Pa. C.S.

§ 523(a), (b)(1). The Company interprets this to mean that "The Commission is required to consider management effectiveness in setting rates. *See* 66 Pa.C.S. § 523 (in determining just and reasonable rates, the Commission shall consider a public utility's management effectiveness, operating efficiency and activity or inactivity regarding conservation)." PPL Electric MB at 115. The Company's characterization of this requirement is misleading. The record contains no audit conducted and entered into the record within the meaning of the Public Utility Code, and therefore, this section cannot be interpreted to mandate the evaluation of management efficiency.

Independent of the section relied upon by the Company in error, the Commission may include an incremental upward adjustment to the cost of common equity to reflect management effectiveness. *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, R-00072711, 2008 Pa. PUC LEXIS 50, \*63 (July 31, 2008); *Pa. P.U.C. v. West Penn Power Co.*, Docket Nos. R-00942986, *et al.*, 1994 Pa. PUC LEXIS 144, \*147 (Dec. 29, 1994). The Company seeks 12 basis points, and I&E and OCA oppose any allowance for management effectiveness.

The Company summarizes its own evidence as follows:

PPL Electric’s management is effectively controlling costs, while at the same time, providing customers with high quality service and expanded service options. As detailed in the Statement of Reasons, the Company has taken substantial efforts to improve productivity and manage costs, including, but not limited to: (1) new technology to improve productivity and including advanced meters; (2) a smart grid distribution automation system, which will provide direct reliability benefits to over 60,000 customers in the project area and lead to increased reliability benefits to all customers by providing system operators advanced and timely situational awareness and control capabilities through a wider deployment throughout PPL Electric’s service territory; (3) a work and asset management system, which is a new large scale software solution that will improve associated work management business processes in order to more effectively and efficiently manage the portfolio of work; (4) several initiatives to improve storm processes including call handling time and volume; (5) increased investment to address aging infrastructure, which will have a positive, long-term benefit in controlling reactive operating costs; and (6) capital investment in information systems to support customer choice and to provide expanded self-service options for customers, which improves service to customers while controlling operating costs. In addition, the Company is testing and evaluating a variety of applications and features that will expand the capabilities of the current system and equipment over the next five years. PPL Electric St. 1, p. 7; PPL Electric Ex. 1, Statement of Reasons.

Although all utilities are required to deploy smart meters, PPL Electric is the only utility in the Commonwealth that has deployed smart meters to all of its customers. PPL Electric also is actively pursuing and implementing smart grid technology. PPL Electric plans to deploy self-healing smart grid functionality to approximately 50% of all customers and circuits by 2019. PPL Electric Ex. 1, Statement of Reasons, pp. 9-10.

PPL Electric is in the process of developing an enterprise work and asset management system that will be used to optimize maintenance and aging infrastructure programs. As the system is deployed, it will provide the future capability to more effectively store conditional and operational information associated with specific assets. The Company’s plan is to leverage this new asset information to optimize maintenance and aging infrastructure replacement programs. PPL Electric Ex. 1, Statement of Reasons, p. 10.

After the historic storms of 2011, PPL Electric has undertaken new initiatives to improve storm processes and systems, including:

* Hardware and software upgrades of the Company’s Outage Management System to speed outage processing;
* Integration with a third-party service to handle customer outage calls when the telephone infrastructure reaches capacity;
* Revamped damage assessment processes to better utilize employees with mobile damage reporting capabilities and, in some cases, utilize retirees;
* Re-configured regional storm centers to optimize the flow of outage information and provide all required support; and
* Implementation of improved estimated restoration time (“ERT”) processes and associated metrics.

PPL Electric Ex. 1, Statement of Reasons, p. 11.

The Company has successfully deployed a comprehensive family of programs to meet its requirements under Pennsylvania Act 129. That Act requires electric distribution companies to work with customers to reduce energy use by 1 percent by May 31, 2011, and 3 percent by May 31, 2013. It also requires a 4.5 percent reduction in peak demand by May 31, 2013. The Company met the 2011 requirement and expects to meet both of the 2013 requirements. PPL Electric Ex. 1, Statement of Reasons, p. 12.

PPL Electric implemented a pilot program that allows residential customers to use self-serve tools (IVR and the web) to establish payment agreements. No other utility has implemented such a program. This program has been highly successful over 2011, with 275,000 self-serve payments and 107,000 self-serve payment agreements. PPL Electric Ex. 1, Statement of Reasons, pp. 13-14. Given the success of the program, PPL Electric plans to request Commission approval to implement the program on a permanent basis.

In 2011, for the ninth time, PPL Electric was ranked highest among large electric utilities in the eastern United States in J.D. Power and Associates’ annual study of business satisfaction. PPL Electric St. 1, p. 8. On July 12, 2012, the Company received its 18th J.D. Power and Associates award for being first in customer satisfaction in the eastern United States. PPL Electric St. 3-R, pp. 23-24.

PPL Electric has undertaken many activities and programs to provide an educational foundation to help consumers understand a variety of issues associated with shopping for electricity, the importance of energy efficiency and conservation, and the steps they can take to help them control the size of their electric bills. PPL Electric Ex. 1, Statement of Reasons, pp. 14-15; PPL Electric St. 6-R, p. 7.

PPL Electric has been an active supporter of competition. Nearly 75% of the energy consumed in the PPL Electric service territory is provided by EGSs. PPL Electric Ex. 1, Statement of Reasons, p. 14. Further, PPL Electric has the highest percentage of total customers shopping in Pennsylvania among large EDCs. The statewide average of shopping customers is 31.1%, while PPL Electric’s total is approximately 42%. PPL Electric has the highest referral rate to the papowerswitch.com website. PPL Electric consistently led in “hits” to the website from its customers, compared to other EDCs. PPL Electric St. 6-R, p. 7; PPL Electric Ex. TCS-2.

PPL Electric also has been a leader in the development and implementation of universal service programs. PPL Electric explained that:

In 1980, PPL Electric was the first utility in Pennsylvania to develop and implement CARES, which is an outreach and referral service for household confronted with hardships. The Commission issued a Secretarial Letter on May 31, 1985 (Docket No. M-840403) encouraging regulated utilities in the state to implement CARES programs. The Company was one of the first electric utilities to implement a utility-sponsored hardship fund (“Operation HELP”) in 1983. Among regulated utilities, Operation HELP has been a top fund raiser in Pennsylvania. From the start of the program in 1983 through 2011, the Company has donated and raised approximately $23 million to assist 80,000 low-income households. In 1985, PPL Electric introduced the first utility-sponsored weatherization program (“WRAP”) for low-income households in Pennsylvania. The Commission promulgated regulations in 1988 (Chapter 58, Residential Low-Income Usage Reduction Programs) requiring utilities to implement low-income weatherization programs. As noted earlier, from 1985 through 2011, PPL Electric has expended approximately $128.4 million to provide weatherization services to 70,000 low-income households.

PPL Electric St. 9-R, pp. 26-27; PPL Electric MB at 120-122.

I&E argues that the 12 points sought translates into an additional $3 million in rate revenues. Tr. at 335; I&E MB at 116. I&E argues further that there is considerable room for improvement in several areas, including preventable major outages, customer service calls answered within 30 seconds, the number and percentage of bills not rendered to residential customers and small businesses, and number of disputes with no response within 30 days. I&E MB at 119-120. In addition, there is little evidence that the level of shopping in this Company's service territory was due to any action on PPL Electric's part, and education funding is provided elsewhere. I&E MB at 120-121. As I&E sees it:

Industry awards should not support an additional award of equity points. Customers already pay for the service they receive. They should not be compelled to pay more because of how J.D. Powers ranks them pursuant to a survey that is not part of this record and has not been subject to any regulatory review or input.

PPL provides no evidence that it has exceeded its stator and regulatory just and reasonable rates. PPL's requested 12 basis point upward adjustment to the cost of equity is neither warranted nor supported. It should be rejected.

I&E MB at 123.

OCA agrees. It points to the $832,000 that PPL Electric either agreed to or was ordered to pay in fines and penalties. OCA Cross Exhibit 1; OCA MB at 65.

PPL Electric presented substantial evidence of management effectiveness in a number of areas, including advanced metering infrastructure, operating initiatives, customer contact center, customer education, energy efficiency programs, and customer assistance programs. To be clear, the provision of safe, reliable, adequate and reasonable service is the minimum required by the Public Utility Code, and simply meeting that standard does not warrant excessive rewards. The Company points out:

The principal issue is not whether PPL Electric’s various practices, processes, or programs are superior to other electric utilities, or whether the programs and initiatives are funded by ratepayers. Rather, the principal issue is the broad scope of PPL Electric’s efforts to improve its operations in ways that strengthen reliability, enhance customer satisfaction, respond to customer needs, and reinforce public and employee safety. It involves a commitment to customer services, effective leadership, operational excellence, and a culture of continuous improvement.

PPL Electric MB at 122.

The actions taken by this utility in its response to Commission initiatives, and in providing excellent (albeit imperfect) service, in meeting the needs of its ratepayers and customers, merits a management effectiveness increase of six basis points.

**e.** **Summary** **PPL’s Return on Common Equity**

As noted above, there are four methods of determining the cost of equity: Discounted Cash Flow (DCF), Risk Premium (RP), Capital Asset Pricing Model (CAPM), and Comparable Earnings (CE).

I&E argues that equal weight should not be given to the four different methodologies as PPL Electric witness Moul does in his evaluation:

The CAPM suffers from being an indirect measure of the cost of equity that is easily manipulated depending on the time period employed in the analysis. The CE methodology is subjective in terms of the selection of comparable companies, has generally been rejected by the Commission, and, in Mr. Moul’s particular analysis, compares projected returns of companies of dissimilar business and financial risk.[[36]](#footnote-36) The RP is merely a simplified version of the CAPM – the “evil clone” of the CAPM as stated by the author of an article relied upon by Mr. Moul[[37]](#footnote-37) – and therefore suffers the same flaws. In addition, in calculating equity risk premium, Mr. Moul concludes his analysis at 2007, leaving out 4 years (2008-2011) of data.[[38]](#footnote-38)

While Mr. Moul cites the Lehman Brothers bankruptcy as a reason to conclude his analysis at 2007, omitting this data not only renders it stale, but also since Lehman Brothers announced bankruptcy four years ago, continuing to use 2007 data does not allow for determining a *current* cost of equity. Even if the markets have almost returned to pre-financial crisis levels as Mr. Moul asserts, his omission renders his data analysis incomplete and dated. If the markets have recovered to about 91% of the peak level prior to the financial crisis, meaning the 2012 numbers are 91% of what they were in 2007, omission of those four years of data in theory causes the current cost of equity (2012) to account for only 91% of Mr. Moul’s determined cost of equity (2007).

Although Mr. Moul presents no evidence what this number would be if based upon a complete and current analysis, Ms. Sears does. Using Mr. Moul’s 91% figure but not correcting for the other flaws identified by Ms. Sears, Mr. Moul’s RP determined through 2007 should be lowered to 9.78% (10.75% x 91%) for 2012. Clearly this missing data is an important factor and must be included if determining the appropriate cost of equity using the RP model.[[39]](#footnote-39)

I&E MB at 91-93.

OCA and I&E both take issue with the Company's analysis in arriving at the proposed cost of equity and capital structure. As OCA points out, the Commission has indicated a preference for using the DCF method to establish reasonable common equity costs.

Historically, we have primarily relied on the DCF methodology in arriving at our determination of the proper cost of common equity. We have, in many recent decisions, determined the cost of common equity primarily based upon the DCF method and informed judgment. *See Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, 71 Pa. PUC 593, 623-632 (1989); *Pennsylvania Public Utility Commission v. Western Pennsylvania Water Company*, 67 Pa. PUC 529, 559-570 (1988); *Pennsylvania* *Public Utility Commission v. Roaring Creek Water Company*, 150 PUR4th 449, 483-488 (1994); *Pennsylvania Public Utility Commission v. York Water Company,* 75 Pa. PUC 134, 153-167 (1991); *Pennsylvania Public Utility Commission v. Equitable Company*, 73 Pa. PUC 345-346 (1990). We determine that the DCF method is the preferred method of analysis to determine a market based common equity cost rate.

Pa. PUC v. Pennsylvania American Water Company, 99 Pa. PUC 38, 42 (2004) (PAWC 2004), aff’d on other grounds, Popowsky v. Pa. PUC, 868 A.2d 606 (Pa. Commw. Ct. 2004); accord Pa. PUC v. Aqua Pa, Inc., 99 Pa. PUC 204, 233 (2004).

OCA MB at 50.

PPL Electric witness Moul relies on the DCF, CAPM, RP, and CE methodologies in presenting his recommended return on equity. Based upon the use of his EDG and IEG barometer groups, Mr. Moul calculates the following equity returns:[[40]](#footnote-40)

|  |  |  |
| --- | --- | --- |
| Measure | EDG | IEG |
| DCF | 10.37% | 10.87% |
| RP | 10.75% | 10.75% |
| CAPM | 11.78% | 12.48% |
| CE | 11.60% | 11.60% |
| Average | 11.13% | 11.43% |
| **Indicated Cost of Equity** | | **11.25%** |

While calculating average returns on equity for his respective groups of 11.13% and 11.43%, Mr. Moul’s indicated cost of common equity reflects his upward adjustment of 70 basis points for his EDG and 118 basis points for his IEG to account for his leverage claim. It further reflects his upward adjustment of 120 basis points for both EDG and IEG to reflect his claim that PPL has higher business risk due to its small size relative to his proxy group. Finally, his indicated cost of common equity reflects his upward adjustment of still another 12 basis points to reflect PPL’s requested award for claimed management efficiency.[[41]](#footnote-41)

I&E witness Sears opposes Mr. Moul’s calculated return on equity for several reasons. First, as stated above in the discussion of barometer groups, Mr. Moul’s selected barometer group is flawed in that several of his selections fail to meet even Mr. Moul’s own purportedly objective selection criteria. Second, Mr. Moul gives undue weight to the RP and CE methods. Third, Mr. Moul employs an inflated DCF growth rate and a dividend yield adjustment that is unnecessary. Fourth, Mr. Moul employs inflated CAPM betas. Finally, Mr. Moul’s extra-method adjustments for leverage, size (business risk), and management efficiency are unsupported and inappropriate.

The Commission’s preferred method of determining a utility’s ROE is the DCF model. Consequently, I&E’s DCF analysis consisting of a dividend yield of 4.89% and a growth rate, prior to Ms. Sears’ log-linear adjustment, of 4.79% is appropriate. Additionally, a six basis point adjustment to PPL Electric’s ROE for management effectiveness is warranted; the sum of which results in an overall ROE of 9.74%.

**f. Overall Rate of Return**

The Company’s proposed overall rate of return is 8.42%.[[42]](#footnote-42) I&E’s proposed overall rate of return is 6.84%.[[43]](#footnote-43) I&E submits that the evidence in this proceeding does not support the inputs that went into the development of PPL’s proposed return on equity, capital structure, or overall rate of return.

The evidence supports the Company’s position of a capital structure consisting of 49.22% long-term debt and 50.78% common equity along with a long-term debt cost rate of 5.50%. Additionally, based on the evidence presented by I&E and the Company a cost of equity capital of 9.74% is warranted. Based on the forgoing, the resulting overall rate of return is 7.65%.



The evidence overwhelmingly demonstrates that PPL’s claim for a return on equity of 11.25% and an overall rate of return of 8.47% overstates what reasonable investors should expect from a regulated public utility and is not necessary for PPL Electric to safely and reliably provide electric distribution service to its captive ratepayers.

When adjusted to a more reasonable level that approximates expected returns in today’s economy for similarly-situated EDCs, PPL’s evidentiary support for its $104.6 million rate increase is properly reduced. PPL’s proposed rate of return is not supported by substantial record evidence and is improperly calculated. Based on the evidence presented, the appropriate overall rate of return that will result in just and reasonable rates is 7.65% based on a 9.74% cost rate of common equity.

**G. TAXES**

**1. Gross Receipts Tax**

PPL Electric’s total future test year gross receipts tax expense claim is $50,102,000, which is comprised of two components. The first component is a pro forma calculation of gross receipts tax for the future test year at present rates of $43,930,000 (PPL Electric Ex. Future 1, Sch. D-11, p. 3) and the second component is $6,172,000 resulting from the proposed increase in rates. PPL Electric Ex. Future 1-Sch. D-12, p. 6. PPL Electric MB at 133. I&E recommends a downward adjustment of $934,000.

I&E explains that the Pennsylvania gross receipts tax (GRT) is a tax imposed on EDCs’ receipts from sales and distribution of electricity at a total tax rate of 59 mills (i.e. the equivalent of a 5.9% tax rate). The Company’s claim is based upon its estimated total billed base rate revenues subject to this tax.

I&E witness Morrissey recommends a total GRT allowance of $49,168,000, which is a $934,000 reduction to the Company’s total claim. The recommended allowance comprises a recommended pro forma allowance of $43,100,000 and a rate increase allowance of $6,068,000 (assuming a full rate increase). The respective recommended GRT adjustments are reductions of $830,000 to the pro forma claim and $104,000 to the rate increase claim.

Ms. Morrissey bases her recommendation on the fact that the Company’s tax liability for the GRT is limited to the *actual* revenues it receives. Therefore, Ms. Morrissey recommends that the GRT tax allowance in rates should be calculated using the net revenues collected by the Company.

To determine the appropriate GRT allowance, Ms. Morrissey reduced gross billed revenues by the uncollectible expense because the Company does not incur a GRT tax liability on uncollected billed revenues. Ms. Morrissey reduced the Company’s claimed pro forma revenues by the corresponding claimed pro forma uncollectible expense and applied the 59 mills to the net revenue to determine the pro forma GRT allowance and corresponding adjustment, i.e. a $830,000 reduction. For the GRT adjustment resulting from the Company’s requested revenue increase, similarly Ms. Morrissey determined the net revenues by reducing the revenue increase request by her recommended uncollectible expense amount and applied the GRT tax rate and compared the recommended allowance to the Company’s claim to determine the corresponding adjustment, i.e., a $104,000 reduction.[[44]](#footnote-44) I&E’s recommendation to calculate the GRT allowance using net revenues is appropriate because it is a better match of the claimed actual receipts of revenue that will produce the Company’s actual GRT tax liability.[[45]](#footnote-45)

I&E MB at 69-70.

PPL witness Kleha claims that the Pennsylvania Department of Revenue (DOR) requires PPL to file its GRT returns using an accrual method of accounting and not actual revenues received, and that the DOR’s documentation requirements for write-offs are very onerous, including matching write-offs to customers in the applicable tax period.[[46]](#footnote-46)

The Company argues:

Under the recent Department of Revenue Corporate Tax Bulletin on gross receipt tax, PPL Electric’s liability for gross receipts tax is **not** limited to actual revenues received. Instead, PPL Electric is required to file its gross receipts tax utilizing the accrual method of accounting. Further, the Corporate Tax Bulletin establishes a reduction against taxable gross income in the tax year when specific customer accounts actually are written off. This reduction, however, is subject to onerous documentation requirements including matching of each write-off amount by customer to the tax period during which the receipts were reported as taxable to Pennsylvania. Another difficulty, that PPL Electric presently does not have the capability of resolving, is that PPL Electric’s current system for applying customer payments does not separate payments from customers between PPL Electric revenue and revenue that it bills for EGSs (who are required to remit their own gross receipts tax payments) and purchased accounts receivable. PPL Electric St. 8-RJ (Part 1), pp. 36-37.

In order to obtain the necessary detail at the individual account level, as required by the Department of Revenue, PPL Electric would have to implement significant and costly system changes that would require ongoing IT support and business resources. Due to the complexities of PPL Electric’s billing and payment system, significant testing and corrective actions would be needed to address and resolve the various potential “glitches” identified during the implementation process. Based on the volume of customer accounts written off by PPL Electric each year, the resources that would be required to perform the matching of write-offs to tax periods would not be cost effective. PPL Electric St. 8-R, pp. 36-37.

PPL Electric’s calculation of gross receipts tax should be approved because utilizing the deduction for uncollectible accounts, as recommended by I&E, is not practical at this time for PPL Electric now and for the foreseeable future.

PPL Electric MB at 135.

Ms. Morrissey maintains her proposed adjustment. Mr. Kleha’s claims about accrual accounting and his reliance on the DOR Corporate Tax Bulletin (supplied as I&E Ex. 2-SR, Sch. 1) do not invalidate Ms. Morrissey’s adjustment. To the contrary, the bulletin confirms that the Company’s net uncollected revenues will reduce its GRT tax liability, supporting Ms. Morrissey’s proposed adjustment. As to Mr. Kleha’s claim that the DOR has denied the Company’s proposal to reduce its taxable revenue by its uncollectibles expense, that claim is unsubstantiated because the DOR audit is incomplete. Finally, Mr. Kleha’s claim that the process of documenting uncollected revenues by customer by tax year is burdensome and costly is not credible. Mr. Kleha offers no support that the cost of documentation would exceed the Company’s overvaluation of its GRT absent the documentation. And Mr. Kleha admitted on cross-examination that the Company maintains records of customers’ bad debt.[[47]](#footnote-47)

The Department of Revenues Corp Tax Bulletin confirms that the Company’s net uncollected revenues will reduce the GRT liability. The Company has not provided any support that the cost of documentation would exceed the overvaluation of GRT. The Company’s witness Kleha also confirmed the Company maintains records of customers’ bad debt. For the reasons stated, I&E’s recommendation to calculate the GRT allowance using net revenues is reasonable and recommended for approval.

**2. PA Capital Stock Tax**

PPL Electric’s pro forma future test year capital stock tax liability is $2,098,000, PPL Electric Ex. Future 1, Sch. D-12, p. 7, which was calculated by applying the currently effective tax rate of 1.89 mils, or 0.189 percent, to the corporation’s net worth, as determined under the applicable capital stock tax rules. I&E St. 2, p. 49. I&E proposes to adjust PPL Electric’s capital stock tax. It recommends that the capital stock tax be calculated based upon the capital stock tax rate of 0.89 mils, or 0.089 percent, that will become effective on January 1, 2013. I&E St. 2, pp. 49-50.

The Company argues that the capital stock tax rate of 0.89 mils should not be used to calculate base rates in this proceeding:

Instead, the change in tax rate that will become effective January 1, 2013 should be handled through the State Tax Adjustment Surcharge (“STAS”) which is specifically designed to accommodate changes in four different state taxes, including the capital stock tax, public utility realty tax, corporate net income tax and gross receipts tax. 52 Pa. Code §§ 69.51, *etc.* Consequently, any change in the capital stock tax rate and any resulting change to PPL Electric’s resulting tax liability should be handled through the STAS mechanism which is subject to annual reconciliation. 66 Pa.C.S. § 1307(e).

Because there is a currently effective mechanism for dealing with state tax rate changes, it is unnecessary to reach beyond the end of the future test year, as I&E proposes to do. Instead, PPL Electric’s reconcilable STAS should be used as it has been designed by the Commission. PPL Electric St. 8-R, p. 38.

PPL Electric MB at 135.

PA Capital Stock Tax is a state tax imposed on a corporation’s net worth. The current tax rate is 1.89 mils or 0.189% taxation of a computed modified net worth amount. This corporate tax is being phased out gradually and will be reduced January 1, 2013. The Company’s FTY claim is $2,098,000 using the existing 0.189% tax rate.

I&E witness Morrissey proposes a Capital Stock Tax allowance of $873,000, which is a $1,225,000 reduction to the Company’s claim. The primary basis for Ms. Morrissey’s adjustment is her recognition that this tax is gradually being phased out and that the tax rate used will change in 2013, decreasing to 0.89 mills or 0.089%, effective January 1, 2013.

While the Company’s State Tax Adjustment Surcharge (STAS) clause in its tariff can accommodate changes in tax rates such as the PA Capital Stock Tax, Ms. Morrissey contends that the Company should use the applicable PA Capital Stock tax rate that will be in effect at the expected implementation date of any rate changes that result from this proceeding. This will alleviate any immediate tariff changes required because of a known tax rate change that differs from what is used in the base rate proceeding and give the financial benefit of the lower tax rate to ratepayers in a more timely fashion. Since the Company expects the tariff effective date of any rate changes resulting from this proceeding to be implemented January 1, 2013, it would be appropriate to use the applicable PA Capital Stock Tax rate for 2013.[[48]](#footnote-48)

PPL witness Kleha contests Ms. Morrissey’s adjustment. Mr. Kleha states the Company’s STAS is the appropriate mechanism to reflect the capital stock tax rate reduction because it will ensure that PPL recovers no more or less that the actual tax liability for the year.[[49]](#footnote-49)

I&E witness Morrissey maintains her proposed adjustment. Her recommendation will not only result in STAS being set to zero when rates go into effect, but also aid in maintaining STAS to stay at or near zero for the entire year in accordance with the requirements of 52 Pa. Code § 69.52. This recommendation uses known and measureable tax rates and benefits both the Company and ratepayers by reducing reconciliation complexity and eliminating any need for refunding. This, in turn, allows customers to keep their monies in pocket upfront for other immediate uses.[[50]](#footnote-50)

An identical adjustment was raised by I&E (then OTS) and opposed by PPL in the Company’s 2004 base rate case. The ALJ agreed with the OTS that the allowance for the CST “should be forward looking” and should be set based upon the tax rate to be effective January 1, 2005, not the older, higher rate claimed by PPL.[[51]](#footnote-51) PPL did not except. The identical adjustment was also a specifically identified component to what was otherwise a black box settlement of PPL’s 2007 base rate case, with PPL agreeing to incorporate the anticipated January 1, 2008 CST reduction into the filing, eliminating the need for the Company to file a STAS.[[52]](#footnote-52) The same result should occur in this base rate proceeding.

The Capital Stock tax is expected to be reduced to .89 mils in 2013 and completely phased out by 2014 (per DOR). These rates are known & measurable. Also the 2004 and 2007 rate cases used the CST rate that would be in effect at the date the new rates were implemented. Therefore, I&E’s recommendation to use .89 mils to calculate the CST should be approved.

**3. Consolidated Tax Savings**

PPL Electric is a wholly-owned subsidiary of PPL Corporation, which each year, files a consolidated federal income tax return for all members of the Corporate System:

Through the consolidated federal income tax return, the PPL Corporate System is permitted to offset net tax losses of certain affiliated companies against net taxable income, thereby reducing the federal income tax liability of the Corporate System in comparison to the total tax liability of all of the affiliates if they filed federal income tax returns on a stand-alone basis. Under application of the “actual taxes paid” ratemaking doctrine, subject to certain limitations and exceptions, public utilities are required to flow through to ratepayers their actual savings from participating in a consolidated federal income tax return. *Barasch v. Pa. P.U.C.*, 507 Pa. 561, 493 A.2d 653 (1985).

PPL Electric MB at 130.

In accordance with this precedent, PPL Electric performed a calculation of consolidated federal income tax savings. The savings calculation is set forth in PPL Electric St. Future 1-Revised, Sch. D-12, p. 4. PPL Electric’s calculation was based on a three-year average of the consolidated tax savings generated by the PPL Corporate System. PPL Electric performed its calculation using data from the three most recent years for which actual data are available, 2009 – 2011. PPL Electric St. 8, p. 16. However, under the particular facts and circumstances of this proceeding, no consolidated tax savings adjustment is appropriate because PPL Electric, for 2012, the future test year in this proceeding, will not be able to take advantage of any theoretical consolidated tax savings because it is incurring a net operating loss for federal income tax purposes. Similarly, it experienced a net operating loss for federal income tax purposes for the historic test year. PPL Electric St. 8, p. 14.

PPL Electric MB at 131.

Consolidated Tax Savings is the result of allocating tax loss deductions of affiliate companies to the positive tax companies of that same parent holding company group that comprise a federally-filed consolidated tax return. Though the Company computed a Consolidate Tax Savings, it claimed zero dollars in its FTY. The basis for the Company’s claim is that PPL is in a current tax loss position.

I&E witness Morrissey recommends applying the computed Consolidated Tax Savings that is applicable to jurisdictional activity to the Company’s FTY, resulting in a tax savings of $210,000. The basis for I&E’s adjustment is that the Company has claimed a positive, normalized federal income tax expense for ratemaking purposes and this claimed positive expense is available and should be reduced by the Company’s allocated share of these consolidated tax savings. This recommendation passes on to ratepayers the tax savings that result from filing a consolidated tax return.[[53]](#footnote-53)

PPL witness Kleha contests Ms. Morrissey’s adjustment. Mr. Kleha asserts that because the Company’s FTY tax position is negative, no consolidated tax savings should apply. Even in consideration of the Company’s proposed rate increase, at which point the Company will be in a positive tax position, Mr. Kleha contends reflection of a consolidated tax savings is premature until the Company files its 2012 tax returns.[[54]](#footnote-54)

I&E’s proposed consolidated tax savings adjustment is appropriate. The Company has proposed a $104.6 million rate increase. In the Company’s FTY, the Company’s claimed *normalized* federal tax position is positive. Stated otherwise, the Company is requesting recovery of federal income taxes for ratemaking purposes. If the Commission grants PPL no rate relief as I&E recommends, no consolidated tax savings adjustment should be applied. However, if the Commission grants a rate increase in any amount at or above $1 million, based upon the Company’s filing and known and measureable tax rates it would be in a positive tax position sufficient to apply the entire computed jurisdictional consolidated tax savings of $210,000. If the Company benefits from the grant of a rate increase, the resulting positive tax position should be offset by a consolidated tax savings (not to exceed $210,000) in order to pass the tax savings benefit to ratepayers by reducing the resultant amount of federal taxes claimed for recovery.[[55]](#footnote-55)

I&E MB at 68-75

I&E’s proposed consolidated federal income tax savings adjustment should be rejected. Contrary to I&E’s contentions, the Commission has established guidelines for the calculation of tax benefits derived from participation by a public utility in a consolidated federal income tax return.

These guidelines permit a jurisdiction utility to: (1) determine a consolidated tax savings benefit based on the average of three most recently available filed consolidated tax-year returns; (2) adjust the taxable income of the utility and its affiliates to exclude all non-recurring items which contributed to their taxable income and tax losses in that three-year period; (3) apply on a pro forma basis any tax benefit determined based on the adjusted historic data to the utility’s future test year results at present rates; and (4) set the adjustment rate to zero, if the utility’s future test year tax position is negative.

PPL Electric St. 8-R, p. 35. As shown in Ex. Future 1, Sch. D-12, PPL Electric’s pro forma results of operations at present rates as adjusted for ratemaking purposes for the future test year ending December 31, 2012 are negative for federal income tax purposes. In other words, PPL Electric is incurring a loss at present. The principal reason for the loss position is bonus depreciation and a resulting tax loss carry forward available to the Company. Bonus depreciation was established under the Small Business Jobs Act of 2010, which was signed into law on September 27, 2010 and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, which was signed into law on December 17, 2010. PPL Electric St. 8, p. 14.

Contrary to I&E’s proposal, consolidated federal income tax savings are calculated at present rates only, before the determination of any rate increase for four principal reasons. First, the consolidated tax savings calculation is properly performed based on the actual federal income data for the utility based upon the parent’s three most recent filed income tax returns. If any calculated consolidated income tax savings can be derived by the utility, such savings are applied to the utility’s test year income tax liability, in this proceeding, 2012. Second, the consolidated tax savings benefit is not applied when the utility is in a tax loss position because the proposed rate increase cannot and will not increase PPL Electric’s taxable income for the 2012 future test year. No consolidated tax savings can be derived by PPL Electric related to its proposed rate increase in this proceeding until the parent files a consolidated tax return for 2013, which will be filed in 2014. As such, I&E’s proposed adjustment is an attempt to reach improperly beyond the end of the future test year in order to find taxable income to which a consolidated tax savings adjustment could be applied. PPL Electric St. 8-RJ (Part 1), pp. 6-7. Third, the calculation of consolidated tax savings must be performed at present rates because it is one of the steps performed in determining whether rate relief is needed. Fourth, as explained above, the consolidated tax savings calculation is an application of the “actual taxes paid” doctrine. *Barasch v. Pa. P.U.C.*, 507 Pa. 561, 493 A.2d 653 (1985). The Supreme Court explained the application of the doctrine as follows:

Although the Commission is vested in broad discretion in determining what expenses incurred by a utility may be charged to the ratepayers, the Commission has no authority to permit, in the rate-making process, the inclusion of hypothetical expenses not actually incurred. When it does so, as it did in this case, it is an error of law subject to reversal.

*Id.*, 507 Pa. at 655, 493 A.2d at 566. I&E’s attempt to calculate consolidated tax savings based on a hypothetical level of taxable income that PPL Electric will not experience during the future test year should be rejected as contrary to law.

I&E’s attempt to impute consolidated tax savings to PPL Electric in this proceeding is improper and should be rejected.

PPL Electric MB at 131-132.

For the reasons stated by PPL Electric, a calculation of consolidated tax savings should not be considered in this case.

**H. Rate Structure**

Establishment of a rate structure is an administrative function peculiarly within the expertise of the Commission. *Emporium Water Company v. Pa. Publ. Util. Comm'n,* 955 A.2d 456, 461 (Pa. Cmwlth. Ct. 2008); *City of Lancaster v. Pa. Publ. Util. Comm'n*, 769 A.2d 567, 571-72 (Pa. Cmwlth. Ct. 2001). The question of reasonableness of rates and the difference between rates in their respective classes is an administrative question for the Commission to decide. *Pennsylvania Power & Light Co. v. Pa. Publ. Util. Comm'n,* 516 A.2d 426 (Pa. Cmwlth. Ct. 1986); *Park Towne v. Pa. Publ. Util. Comm'n,* 43 A.2d 610 (1981). This is further refined by the Electric Competition Act, 66 Pa. C.S. § 2801 *et seq.,* and the *Lloyd* case.

**1. Cost of service**

When a utility files for a rate increase, it must file a cost-of-service study (COSS) assigning to each customer class a rate based upon operating costs that it incurred in providing that service. 52 Pa. Code § 53.53 Exhibit C.IV.E.  *Lloyd v. Pa. Publ. Util. Comm’n,* 904 A.2d 1010 (Pa. Cmwlth. 2006) *appeal denied* 591 Pa. 676, 916 A.2d 1104, fn. 10 (2007)(*Lloyd*). Rates, here the unbundled distribution rates charged to all customers, are required by statute to be just, reasonable and non-discriminatory. 66 Pa. C.S. §§ 1301, 2804(10).

Any approved COSS must reflect sound cost of service principles and ensure that customers are allocated costs in conformance with their impact upon PPL Electric's distribution system. PPLICA MB at 5. The "fundamental purpose of a cost allocation study is to aid in the design of rates to be charged by identifying all of the capital and operating costs incurred by a utility to provide service to all of its customers, and then assigning or allocating those costs to individual rate classes on the basis of how those rate classes cause the cost to be incurred." PPL Electric Stmt. 8 at 22; OCA MB at 68.

"It is generally recognized that to the extent possible, joint costs should be allocated to classes based on the concept of cost causation; i.e., costs are allocated based on specific factors that cause costs to be incurred by the utility." OCA Stmt. 3 at 3-4; OCA MB at 68-69.

OSBA provides detailed testimony and argument to support its position that the Company's COSS (CCOSS):

In its COSS, PPL Electric excludes all costs that are not related to base distribution rates, including energy and capacity costs, transmission costs, uncollectibles costs related to electricity supply, universal service costs, and Act 129 costs. All of these excluded costs are recovered in separate tariff charges or riders.

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. . . PPL Electric sub-functionalized its distribution costs related to a variety of plant assets into "primary voltage" system and "secondary voltage" system components. Similarly, the company sub-functionalizes its operating and maintenance (O&M) costs into primary and secondary system components.

The Company *classifies* most of its primary and secondary plant assets into demand-related and customer-related components. To do so, the Company uses a 'minimum system' method, adjusted slightly for the load carrying capability of secondary system transformers. Meters plant is classified as 100 percent customer-related. O&M and labor costs directly related to specific types of plant are classified in the same proportion as the related plant. The significant change proposed by the Company and approved by the Commission in the 2010 base rates proceeding was to classify most primary voltage distribution plant into both customer-related and demand-related components. Prior to that proceeding, PPL Electric classified all primary system plant as 100 percent demand-related.

Demand-related costs are generally *allocated* among the various rate classes based on class non-coincident peak (NCP) demand. Most customer-0related costs are allocated based on number of customers. Meters plan costs, as well as the customer component of services and transformer plant, are allocated using weighted customer allocators.

Customer accounts costs are allocated in proportion to number of customers. Customer service costs related to the Company's customer assistance program costs are assigned only to the residential classes.

General plant and related O&M expenses, as well as most administrative and general (A&G costs are classified and allocated in proportion using a wages and salaries allocation factor.

Working capital costs are allocated in some detail using a variety of methods, but the large dollar components of working capital costs are materials and supplies, which are classified and allocated in proportion to distribution plant, and working cash costs, which are classified and allocated in proportion to allocated O&M costs.

Taxes other than income taxes are generally classified and allocated in proportion to allocated plant costs. Deferred income tax costs are classified and allocated (in some detail) In proportion to a combination of allocated labor costs and allocated plant costs.

Income taxes are allocated based on taxable rate class income, which is developed (in extraordinary detail) in the Company's COSS.

OSBA Stmt. 1 at 2-4 (citations omitted)(Emphasis in original); OSBA MB a5 3-5.[[56]](#footnote-56)

OSBA states that its primary focus in this case has been to determine whether the COSS presented by the Company conforms to the COSS approved by the Commission in the 2010 base rate case. OSBA concludes that it does, and therefore, there is no need to re-litigate it in this proceeding. OSBA MB at 7. Minor differences are noted. OSBA MB at 7-8.

The filed COSS follows the same principles used by PPL Electric in previous base rate proceedings by utilities using the class maximum NCP demand method, which is based on the highest demand imposed by each rate class on its distribution system, to allocate its demand-related distribution costs. PPL Electric Stmt. 8 at 19; PPLICA MB at 6;

As in 2010, PPL Electric's COSS utilizes a "heightened" level of data analysis using allocators to classify primary voltage level distribution facilities into their demand-related and minimum or no-load customer-related cost components. This method more accurately reflects cost causation than the method used in preceding rate cases, which allocated primary voltage level distribution facilities solely on the basis of demand. PPL Electric Stmt. 8-R at 9; PPLICA MB at 6.

This modification is consistent with NARUC recommendations "that primary voltage level overhead and underground conductors be classified into their demand-related and customer-related cost components." PPL Electric Stmt. 8-R at 9.

I&E takes no position on the COSS. I&E MB at 125. PPLICA, OSBA and REG support the Company's position on COSS allocation and believes that it is consistent with the NARUC manual and reflects a more realistic operation of PPL's system than the OCA counterproposal. REG agrees with the Company's classification of distribution plant as partially customer-related and partially demand-related, and the Company's allocation of the plant. This, REG argues, is consistent with the Commission's disposition of the Company's last rate case as well. REG MB at 4-5.

PPLICA argues in favor of the Company's COSS, which it believes properly allocate primary distribution facilities costs in both a customer and demand component and is consistent with NARUC policies.

Only the OCA opposes the Company's COSS, and on substantially the same grounds as it opposed the Company's COSS in the last base rate case, and which the Commission rejected in that case. OCA argues that primary plant should be classified on a 100% demand basis, with only secondary plant allocated to both demand and customer components. OCA Stmt. 3 at 18. The OCA presents density studies which it claims does not support allocation of distribution plant based on customer count. As a "compromise" position, OCA recommends that the Commission allocate 100% of primary plant on a demand basis and apply OCA's minimum size study to allocate secondary plant on a customer and demand basis.

PPLICA characterizes the OCA approach as "a results-driven density analysis with no meaningful relation to the cost of service principles historically applied by the Commission and supported by NARUC. PPLICA MB at 7. In contrast, PPL Electric's COSS provides a reasonable basis for assessing distribution-related rates of return for each rate schedule, consistent with Commission precedent and NARUC recommendations. PPLICA MB at 8.

According to PPLICA, there are two recognized methodologies to estimate the customer component of distribution costs: the minimum intercept method and the minimum size method, which is the method used by PPL Electric. Each is designed to estimate the component of distribution plant cost incurred by a utility to connect a customer to the system. The minimum size method is designed to reflect costa associated with changes in both the number of distribution customers and the loads of these customers. It reflects a classification of the distribution facilities that would be required to simply interconnect a customer to the system, regardless of the kW load of that customer. PPLICA Stmt. 1-R at 4-5; PPLICA MB at 9.

OCA argues that the parties have misinterpreted the Commission's 2010 Order, that NARUC has updated its cost of service principles since issuing the 1992 NARUC Manual, and argues that its recommendation reflects a compromise.

The other parties reject the OCA arguments most persuasively. For the reasons set forth above, the Company's COSS should be approved, and the OCA alternative denied.

**2. Revenue Allocation**

The basic factor in allocating revenue is to have the rates reflect the cost of service. *Lloyd v. Pa. Publ. Util. Comm'n,* 904 A.2d 1010, 1020 (Pa. Cmwlth. Ct. 2006)(*Lloyd*); PPLICA MB at 12014.

This case is the fourth in a series which have purportedly attempted to move PPL Electric's distribution rates to true cost of service. PPL Electric Stmt. 5 at 8; PPL Electric MB at 152. The Company sought to establish cost of service, and then to apply those costs to the appropriate rate schedules. Because that produced a result that was not just and reasonable, the Company developed an alternative allocation which limits the increase to Rate RTS from 165% to about 78%. The goal is to bring all rate classes closer to the system average rate of return, while still considering the principle of gradualism. PPL Electric Stmt. 5 at 10; PPL Electric MB at 153. The Company's proposal is as follows:

|  |  |  |
| --- | --- | --- |
|  | **Relative Rate of Return** | |
| **Rate Classes** | **Present Rates** | **Proposed Rates** |
| RS | 63.03% | 83.81% |
| RTS | -65.31% | 23.05% |
| GS-1 | 133.55% | 99.05% |
| GS-3 | 285.18% | 196.34% |
| LP-4 | 163.36% | 118.44% |
| LP-5 | -90.72% | 98.94% |
| LPEP | 353.09% | 256.26% |
| GH-2 | 86.64% | 103.55% |
| SL/AL | 100.49% | 99.65% |
| Total PA Jurisdictional | 100% | 100% |

PPL Electric Ex. JMK-2, pp. 8-11; PPL Electric MB at 154.

REG and PPLICA support PPL Electric's proposed revenue allocation and scaleback as consistent with the COSS. REG MB at 5; PPLICA MB at 13-17. The Company's proposed revenue allocation moves all rate classes closer to cost of service in accordance with the Company's C~~P~~OSS and consistent with *Lloyd*. I&E takes no position on revenue allocation. I&E MB at 125; I&E RB at 99.

PPLICA points out that Rate Schedule LP-5 customers will experience a 59.1% increase, and although Rate Schedule LP-4 customers do not experience an increase, their current rates remain above cost of service. PPLICA recognizes that the movement towards actual cost of service rates as set forth is reasonable, and does not oppose this allocation. PPLICA MB at 16.

PPLICA argues that the Commission should not give any credence to OCA's COSS, and as the OCA's proposed allocation is based on that flawed COSS, neither should the Commission give any credence to the OCA's recommendation. PPLICA Stmt. 1-R at 8; PPLICA MB at 15.

As the OCA alternative is based on its COSS, and not on the Company's, which is recommended here, the OCA alternative is denied, and the Company's recommendation is recommended here, the actual numbers to be based on the proportionate adoption of actual revenue requirement approved.

**3. Scaleback Recommendation**

The Commonwealth Court has recognized that, although the cost of service is the "polestar" of establishing rates:

Rate structure, which is an essential, integral component of rate-making, is not merely a mathematical exercise applying theoretical principles. Rate structure must be based on the hard economic facts of life and a complete and thorough knowledge and understanding of all the facts and circumstances which affect rates and services; and the rates must be designed to furnish the most efficient and satisfactory service at the lowest reasonable price for the greatest number of customers, i.e., the public generally. While cost to serve is important, other relevant factors may also be considered.

*Lloyd* at 1016.

Should the Commission approve a lesser revenue requirement than sought, there follows a decision to determine where the scaleback in rates will fall.

PPL Electric and OCA support a proportional scaleback, with no change in revenues for classes that do not receive a rate increase. PPL Electric Stmt. 5-R at 4; OCA Smt.t 3 at 42.

I&E proposes applying the first $1,784,000 to lower the revenue requirement for Rate Schedule RTS customers, with any further reductions applied to Rate Schedules RS, GH--2, SL/AL, and on a conditional basis, LP-5. I&E Stmt. 3 at 16-17.

OSBA recommends a revenue-based scaleback which would allocate any overall rate increase approved by the Commission to each rate class in proportion to the Company's proposed revenues from each class. OSBA Stmt. 1 at 13;

PPLICA supports the scaleback recommendation proposed by OSBA in the event that the Commission approves an overall revenue increase lower than the Company's requested $104.6 million increase. PPLICA argues that application of a proportional scaleback in this proceeding would hinder progress to cost of service rates by reducing rate increases for customers paying below cost of service rates pursuant to PPL's COSS but not allowing correlating adjustments for customers whose present rates are above cost of service. OSBA Stmt. 1 at 13.

Nevertheless, should the Commission not adopt the OSBA recommendation, PPLICA asks that the scaleback be applied to all rate classes receiving an increase as proposed by the Company and OCA, with no further exclusions, as would apply under I&E’s proposal. PPLICA MB at 18. PPLICA opposes the restrictions on the scaleback for Rate Schedule LP-5 that I&E recommends, since that rate schedule is already targeted for a substantial increase. PPLICA MB at 19.

In the *Lloyd* decision, the Commonwealth Court disapproved the setting of rates according to a flat across-the-board percentage because there was no dispute that the cost of serving each rate class varied, and that rates for certain classes were subsidizing rates for others, in the interest of keeping the increase in the total bills of each class to 10% or less. Accordingly, any scaleback should be utilized to bring the rates of each rate schedule closer to the cost of service.

However, this concept, applied blindly, would result in reductions to customers who were not expecting an increase, or greater reductions to some customers than were originally proposed, to the detriment of those whose rates will rise more than necessary. The Company's proposal to apply any scaleback on a proportional basis to only those rate schedules which receive increases is recommended.

**4. Tariff Structure**

**a.** **Rate design**

The Company explains its rate schedules as follows:

Rate Schedule RS-Residential Service: In PPL Electric’s presently effective residential Rate Schedule RS, a large portion of the distribution revenue is being collected through usage or kWh charges. PPL Electric’s minimum size system study indicates that residential customers should be paying a monthly customer charge in excess of $30 as compared to the current monthly charge of $8.75. In this proceeding, PPL Electric has proposed to increase the customer charge for Rate Schedule RS from $8.75 to $16.00 per month and decrease the kWh charges from $0.03364 to $0.03340. PPL Electric St. 5, pp. 11-14; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. PPL Electric’s proposal to increase the customer charges and reduce the energy charge for Rate Schedule RS is consistent with *Lloyd*, which held that rate structures should be adjusted to reflect the cost of service to each rate class and to eliminate cross-subsidization*. I&E, OCA, and CEO oppose PPL Electric’s proposal to increase the Rate Schedule RS customer charge, which the Company addresses below.*

Residential Thermal Storage – Rate Schedule RTS: As previously explained, the increase in revenue requirements for Rate Schedule RTS was capped to limit the increase to approximately one-half the amount require to move this rate schedule to the system average. The customer charge for Rate Schedule RTS presently is $18.06. PPL Electric has proposed that the entire increase to Rate Schedule RTS be recovered through kWh charges. Therefore, PPL Electric proposes that the customer charge for Rate Schedule RTS remain at $18.06, and that the kWh charges be increased from $0.01425 to $0.02598. PPL Electric St. 5, p. 14; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. PPL Electric’s proposal is consistent with the principles of gradualism, while continuing to move Rate Schedule RTS towards cost of service rates. *This proposal was unopposed and should be approved.*

Residential Time of Date – Rate Schedule RTD: The distribution rates charged under Rate Schedule RTD are identical to the distribution rates charged under Rate Schedule RS. Rate Schedule RTD is an older rate schedule that has been superseded by the Time of Use (“TOU”) rate option under GSC-1. PPL Electric therefore has proposed to eliminate Rate Schedule RTD. PPL Electric St. 5, p. 14; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. *I&E opposes PPL Electric’s proposal to eliminate Rate Schedule RTD, which the Company addresses below. No other parties opposed this proposal*.

Small General Service – Rate Schedule GS-1: PPL Electric has proposed to increase the customer charge from $14.00 to $16.00 per month and decrease the demand charge from $4.530 to $4.258 per kW. PPL Electric has installed demand meters on all GS-1 customer premises, except for small unmetered constant load accounts. PPL Electric St. 5, p. 15; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. PPL Electric’s proposal to increase the customer charges and reduce the demand charge for Rate Schedule GS-1 is consistent with *Lloyd*, which held that rate structures should be adjusted to reflect the cost of service to each rate class and to eliminate cross-subsidization. *I&E argues that the customer charge for Rate Schedule GS-1 should not be increased, which the Company addresses below. No other parties opposed this proposal.*

Large General Service – Rate Schedule GS-3: PPL Electric has proposed to increase the customer charge from $30.00 to $40.00 per month and decrease the demand charge from $4.510 to $4.192 per kW. PPL Electric St. 5, p. 15; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. PPL Electric’s proposal to increase the customer charge and reduce the demand charge for Rate Schedule GS-3 is consistent with *Lloyd*, which held that rate structures should be adjusted to reflect the cost of service to each rate class and to eliminate cross-subsidization*. I&E argues that the customer charge for Rate Schedule GS-3 should not be increased, which the Company addresses below. No other parties opposed this proposal.*

Large Power Firm Service at 12 kV – Rate Schedule LP-4: PPL Electric has proposed to increase the customer charge from $160.19 to $170.00 per month and decrease the demand charge from $2.136 to $2.127 per kW. PPL Electric St. 5, p. 16; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. PPL Electric’s proposal to increase the customer charges and reduce the demand charge for Rate Schedule LP-4 is consistent with *Lloyd*, which held that rate structures should be adjusted to reflect the cost of service to each rate class and to eliminate cross-subsidization*. I&E argues that the customer charge for Rate Schedule LP-4, should not be increased, which the Company addresses below. No other parties opposed this proposal.*

Large Power Interruptible Service at 12 kV – Rate Schedule IS-P: There are only two accounts on Rate Schedule IS-P, both owned by the same corporation. PPL Electric has proposed to eliminate Rate Schedule IS-P and move these two accounts to Rate Schedule LP-4. From a delivery perspective, there is no difference between Rate Schedules IS-P and LP-4 because the metering, meter reading, billing, and service are the same. Further these two rate schedules are part of the same default generation supply procurement group. Finally, all of PPL Electric’s interruptible service programs have been superseded by PJM’s programs, and these two accounts are enrolled in the PJM programs. The elimination of Rate Schedule IS-P will not affect the participation of these accounts in the PJM programs. PPL Electric St. 5, p. 16; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. *This proposal was unopposed and should be approved*.

Large Power Service at 69 kV – Rate Schedules LP-5, LP-6, and IS-T: PPL Electric has proposed to increase the customer charge for Rate Schedule LP-5 from $709.00 to $1,125.00 per month. Presently there are only two customers on Rate Schedule LP-6. There is no difference between Rate Schedules LP-6 and LP-5 and, therefore, PPL Electric has proposed to eliminate LP-6 and move the two remaining customers to Rate Schedule LP-5. Finally, PPL Electric has proposed to eliminate Rate Schedule IS-T because there are no customers on this interruptible service program. All of PPL Electric’s interruptible service programs have been superseded by PJM’s programs. PPL Electric St. 5, p. 17; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. *I&E argues that the customer charge for Rate Schedule LP-5 should not be increased, which the Company addresses below. No other parties opposed this proposal.*

Electric Propulsion, - Rate Schedule LPEP: PPL Electric has not proposed any changes to this rate schedule. PPL Electric St. 5, p. 18.

Interruptible Green House Lighting – Rate Schedule IS-1: There currently is only one customer on Rate Schedule IS-1. PPL Electric has proposed to begin phasing out this rate schedule over the next few rate cases. Currently, customers on Rate Schedule IS-1 do not have an incentive to interrupt during an emergency. Accordingly, PPL Electric has proposed a new $25.00 per kW penalty for load that exceeds the interruptible requirement during the period of the requested interruption. PPL Electric also has proposed the elimination of the Time of Day provisions of Rate Schedule IS-1. Instead, the customer’s demand will be the maximum 15-minute demand in the month without Time of Day considerations. Finally, PPL Electric has proposed to decrease the customer charge from $840.00 per month to $40.00 per month, the same as that proposed for Rate Schedule GS-3, and to introduce a demand charge of $2.75 per kW. PPL Electric St. 5, pp. 18-19. *This proposal was unopposed and should be approved*.

Commercial space Heating – Rate Schedules GH-1 and GH-2: All GH-1 customers currently are paying more for distribution service than they would pay on comparable rate schedules. PPL Electric has proposed to eliminate Rate Schedule GH-1 and transfer the remaining customers to Rate Schedules LP-4, GS-3, or GS-1, depending on the service voltage and number of phases supplied by the Company. For Rate Schedule GH-2, the Company proposes to increase the customer charge from $14.00 per month to $16.00 per month. PPL Electric St. 5, pp. 19-20; PPL Electric Exs. DAK 1, DAK 2; PPL Electric Ex. No. 1, Exhibits Regs., § 53.53, Part IV, Questions C through E. *This proposal was unopposed and should be approved.*

PPL Electric MB at 157-162 (emphasis added).

**i. Residential**

The residential distribution schedules are Residential Service (RS), Residential Thermal Storage (RTS), and Residential Time-of-Day (RTD). The Company proposes raising the Rate Schedule RS customer charge from its present $8.75 per month to $16.00 per month. The Company points out that its COSS supports a charge of $36.70, and this increase moves the rate schedule closer to the cost of serving it. PPL Electric MB at 162-163.

OCA opposes the increase to residential customers because it is based on the COSS which it also opposes. This issue was disposed of earlier, and the OCA alternative to the Company's COSS was not adopted. OCA objects further that the Company's proposal will disproportionally impact low-income, low-usage customers and would result in a "significant disincentive" for customers to conserve. OCA MB at 106.

CEO opposes the increase in the fixed monthly customer charge because it takes away a customer's motive and ability to conserve. One of the only defenses that a family has against sharp increases in energy costs is conservation, CEO Stmt. 1 at 5, and this proposal eliminates the ability to reduce that cost through conservation efforts. CEO MB at 7.

The Company points out that there is an energy charge component that is being reduced by 0.7%, and that the distribution charge is small in the context of the energy portion of the bill, which comprises 86% of the charges on the average customer's bill. This still provides an adequate opportunity for savings due to conservation. PPL Electric Smt.t 5-R at 6; Exhibit DAK4; PPL Electric MB at 164.

I&E developed its own offering based upon a direct customer analysis performed by I&E witness Hubert:

**I&E Proposed Class Customer Charges**

**Rate Pres Cust Chrg Cust Cost Analy Prop’d Cust Chrg % Increase**[[57]](#footnote-57)

RS $8.75 $8.13 $8.75 0%

RTS $18.06 $10.94 -- --

GS-1 $14.00 $9.27 $14.00 0%

GS-3 $30.00 $30.96 $31.00 3.3%

LP-4 $160.19 $116.88 $160.19 0%

LP-5 $709.00 $892.28 $892.00 25.8%

I&E MB at 130.

In preparing his direct customer cost analysis, Mr. Hubert was guided by long-standing Commission precedent that identifies the appropriate items to be included in a customer charge. Those items, those that change with the addition or loss of a customer, are the direct customer costs that were identified in the Company’s cost of service study as follows: meter expenses, expenses for services and customer installations, expenses for meter reading and customer records & collection, other customer accounting expenses, depreciation expense and net salvage amortized for meters and services, and the rate base related return and income taxes on customer-based rate base. The Commission has long held these costs to be those most appropriately included in a customer cost study. Most recently the Commission accepted a direct customer cost analysis identical to that conducted by Mr. Hubert in this proceeding[[58]](#footnote-58) in the Columbia Gas of Pennsylvania base rate case at Docket No. R-2010-2251623 (Order entered October 14, 2011).

I&E MB at 131-123(footnotes omitted).

The Company counters that the OCA and I&E alternative customer cost analyses include only meters and services and exclude all other customer costs, which should be included in a customer charge. PPL Electric MB at 170.

The Company points out that "conservation cannot and does not trump cost of service." PPL Electric MB at 164.

In response to the sharp criticism of the other parties, the Company proposes an alternative plan which includes a residential customer charge of $14.09 per month, consistent with the recent Commission decision in the *Aqua* rate case:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| PPL ELECTRIC UTILITIES CORPORATION | | | | | | | | | |
| COST OF SERVICE SUMMARY – RS CUSTOMER CHARGE | | | | | | | | | |
| REVENUE REQUIREMENTS | | | | | | | | | |
| ($1,000) | | | | | | | | | |
|  | | | | | | | | | |
| Customer Class: RS |  | Rate Class     Total | Total Demand | Total Customer | Meters | Services | Meter Reading | Other Cust.     Exps. | Total Direct**1** |
| Rate Base: |  |  |  |  |  |  |  |  |  |
| Plant in Service |  | 3,391,885 | 836,767 | 2,555,118 | 171,016 | 497,616 |  |  | 668,632 |
| Depreciation Reserve |  | 1,249,089 | 280,412 | 968,677 | 94,731 | 241,367 |  |  | 336,098 |
| Net Plant |  | 2,142,796 | 556,355 | 1,586,441 | 76,285 | 256,249 |  |  | 332,534 |
| Subtractive Adjustments |  | 501,254 | 125,655 | 375,599 | 18,061 | 60,668 |  |  | 78,729 |
| Additive Adjustments |  | 46,958 | 10,521 | 36,437 | 1,752 | 5,885 |  |  | 7,638 |
| Total Rate Base |  | 1,688,500 | 441,221 | 1,247,279 | 59,976 | 201,466 |  |  | 261,442 |
| Operating Expenses: |  |  |  |  |  |  |  |  |  |
| Misc Distrib Expenses |  | 12,463 | 3,258 | 9,205 |  |  |  |  |  |
| Customer Service Costs**2** |  | 12,764 |  | 12,764 |  |  |  | 12,764 | 12,764 |
| PUC Annual Assessment |  | 3,635 | 598 | 3,037 |  |  |  |  |  |
| Employee Benefits |  | 23,611 | 3,837 | 19,774 | 6,034 | 783 | 1,390 | 6,969 | 15,176 |
| Other A&G |  | 88,765 | 14,421 | 74,344 | 6,946 | 4,096 | 2,532 | 26,201 | 39,774 |
| Other O&M Expenses |  | 163,328 | 27,626 | 135,702 | 12,678 | 7,476 | 4,621 | 47,826 | 72,600 |
| Proforma Adjustments |  | 3,738 | 627 | 3,111 |  |  |  |  | 0 |
| Depreciation Expense |  | 97,165 | 21,270 | 75,895 | 10,399 | 9,050 |  |  | 19,449 |
| Taxes Other Than Income |  | 6,504 | 1,205 | 5,299 | 255 | 856 |  |  | 1,111 |
| Return | 8.46% | 142,847 | 37,327 | 105,520 | 5,074 | 17,044 |  |  | 22,118 |
| Income Taxes | 41.49% | 68,718 | 17,957 | 50,761 | 2,441 | 8,199 |  |  | 10,640 |
| Tax Adjustment |  | 13,983 | 4,947 | 9,036 |  |  |  |  | 0 |
| Gross Revenue Requirements |  | 637,521 | 133,073 | 504,448 | 43,826 | 47,503 | 8,542 | 93,760 | 193,632 |
| Annualization Adjustment |  | (1,209) | (252) | (957) | (83) | (90) | (16) | (178) | (367) |
| Late Payment Charges |  | 10,668 | 2,227 | 8,441 | 733 | 795 | 143 | 1,569 | 3,240 |
| Other Operating Revenues |  | 27,296 | 7,136 | 20,160 | 1,751 | 1,898 | 341 | 3,747 | 7,738 |
| Total Revenues |  | 36,755 | 9,110 | 27,645 | 2,402 | 2,603 | 468 | 5,138 | 10,611 |
| Net Revenue Requirements |  | 600,766 | 123,963 | 476,804 | 41,424 | 44,900 | 8,074 | 88,622 | 183,020 |
| GRT Base |  | 610,225 | 125,937 | 484,288 | 42,075 | 45,605 | 8,201 | 90,013 | 185,893 |
| GRT Gross-up |  | 648,486 | 133,833 | 514,653 | 44,713 | 48,464 | 8,715 | 95,657 | 197,549 |
| GRT | 5.90% | 38,261 | 7,896 | 30,365 | 2,638 | 2,859 | 514 | 5,644 | 11,655 |
| Total Revenue Requirements |  | 675,782 | 140,969 | 534,813 | 46,464 | 50,362 | 9,057 | 99,404 | 205,287 |
| Customer Charge |  | 64,898 |  | $36.70 | $3.19 | $3.46 | $0.62 | $6.82 | $14.09 |
| Number Customers |  |  |  | 1,214,512 |  |  |  |  |  |
| Annual Customer Billings |  |  |  | 14,574,144 |  |  |  |  |  |
| **Notes:** | | | | | | | | | |
| **1** Includes meters, services and directly assignable operating costs. | | | | | | | | | |
| **2** Excludes Universal Service Rider costs. | | | | | | | | | |

The costs included in PPL Electric’s alternative Rate Schedule RS customer charge of $14.09 per month is included in the black box on the right side of PPL Electric Ex. JMK 5. As illustrated above, the portion of PPL Electric Ex. JMK 5 included in the black box precisely follows the *Aqua* decision and properly reflects meters and services net plant and related O&M expenses; meter reading and billing and collection expenses, and the Company’s Meter Data Management System; and related employee benefits, administrative and general expenses and other O&M expenses related to the above items. These revenue requirement cost components represent the same type of direct and indirect cost components as those approved in *Aqua*. The only difference is that PPL Electric Ex. JMK 5 also includes $12,678,000 for customer call center-related expense. This expense was not specifically addressed in Aqua, but it is consistent with the expenses included in the customer charge in Aqua, because it is a directly assignable customer service-related expense, and it varies with the number of customer calls and the number of customers. PPL Electric St. 8-RJ (Part 2), p. 8.

Although PPL Electric believes that the customer component of each rate schedule should include all customer-related costs determined by the cost of service study, if the ALJ and the Commission wish to consider an alternative compromise customer charge, a charge of $14.09 would be acceptable to the Company as it would recover the same type of direct and indirect cost components as those approved in *Aqua*, and would provide some improvement in the level of fixed cost recovery in the customer charge. In that event, revenue requirements not recovered through the smaller fixed charge would be recovered through a larger usage charge. PPL Electric St. 5-R, p. 15.

PPL Electric MB at 172-173 (citing to *Pa. Publ. Util. Comm'n v. Aqua Pennsylvania, Inc.,* Docket No. R-00038805, 2004 Pa. PUC LEXIS 39, 236 P.U.R.4th 218 (August 5, 2004).

I&E responds by stating that it is improper to offer a compromise outside the context of a settlement, and that without an actual settlement, the Company's position still needs to rely on substantial evidence to support it, which it does not provide here. I&E credibly supports its position by relying on solid case law developed during the time period where integrated electric companies were the norm, and generation subsidized distribution costs.

While it would be improper to propose a compromise position for the first time in a brief or exception, it is not improper to propose an alternative during the litigation, when the supporting data already appears in the record, as it does here. I recommend approval of the PPL Electric alternative as it is based on an approved cost of service study, which clearly illustrates that customer-related costs for the residential class include elements that I&E ignores in its own analysis and determination of a proper residential customer charge. It is reasonable to include some of these additional elements in calculating the residential customer charge, as the Commission allowed in the *Aqua* case. In this way, the Company will be ensured recovery of more of its fixed costs, which are clearly more customer-related than usage-related, while still allowing some revenue to be recovered through usage-based charges. Thus, customers will be provided with more accurate price signals, while still being afforded some opportunity to control their monthly distribution bills through conservation. Also, as the Company points out, its proposal would reduce the usage charge by only a small amount. Moreover, the energy component of a customer’s bill—which is usage-based—comprises the greater proportion of the total bill. Thus, the customer will still have a clear opportunity to substantially reduce its total bill through conservation, notwithstanding the level of the customer component of its distribution charge. For these reasons, it is appropriate and reasonable to accept PPL Electric’s compromise position regarding the residential customer charge.

**ii. Non-Residential Customer charges**

As listed above, the Company proposes increases to Rate Schedules GS-1, GS-3, LP-4, and LP-5,6 and IS-T. I&E uses its own direct customer cost analysis which, the Company argues, excludes certain items that the Company evaluation includes:

The Company continues to believe that its minimum size system study is the appropriate basis for determining the fixed customer costs that are incurred to serve customers, and that those fixed costs should be recovered through a fixed customer charge. As explained above, I&E’s approach to setting the fixed monthly customer charges ignores the customer costs of the fixed and permanent infrastructure that the electric distribution company is obligated to provide and which exists between a customer’s service and the transmission substation from which the customer’s load is served. For these reasons, as more fully explained above, I&E’s proposed non-residential customer charges should be rejected.

PPL Electric MB at 174.

As I have accepted the Company's cost of service-based evaluation for residentials, it is consistent to accept it for the commercial and industrial customers as well. The Company's proposal is recommended for approval.

**iii. Elimination of Rate Schedule RTD**

The Company's proposal to eliminate the Rate Schedule RTD is now unopposed and is recommended for approval. PPL Electric MB at 174-175; I&E MB at 138.

**b. Tariff rules and riders**

In addition to the proposed rate increase and rate design for each class, PPL Electric proposed several changes to various tariff rules and riders. Below is a summary of the major changes proposed by PPL Electric in this proceeding

Major Rule Changes

Tariff Rule 6 – PPL Electric proposed to remove the Adjustments to the Competitive Transition Charge because this Charge expired on December 31, 2010. PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Tariff Rule 6A – PPL Electric proposed to remove the Adjustments to the Competitive Transition Charge because this Charge expired on December 31, 2010. No parties opposed this proposal. PPL Electric also has proposed changes in the Distribution charges for stand-by Basic Utility Supply Service. These proposed changes will have no revenue impact because currently no customers take service under Rule 6A. PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Tariff Rule 8 – PPL Electric proposed to add a Demand Information section to Rule 8. There is a need to efficiently manage the growing number of customer requests for Demand Information as customers begin to enroll in PJM's Demand Side Management ("DSM") programs and TOU rate options. This addition demonstrates PPL Electric's commitment to existing and future DSM programs offered by PJM and the generation marketplace. PPL Electric St. 5, pp. 20-12; PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Major Rider and Charge Changes

Tariff Rule 10 – PPL Electric proposes to increase the fee it charges customers for the reconnection of service from $15 to $30 during normal business hours and from $21 to $50 during non-business hours. PPL St. 5, p. 21; PPL Electric Ex. DAK 2. OCA accepted PPL Electric’s proposal, but recommended that the Company be directed to monitor the costs of reconnection. I&E also accepted PPL Electric’s proposal to increase its reconnection fee, but recommends that the Company’s miscellaneous revenues be increased. These parties’ concerns are addressed above.

Generation Rate Adjustment (GRA) Rider – The GRA Rider expired on January 1, 2011. PPL Electric proposed to remove all references to the GRA from the STAS and Rate Schedules. PPL Electric St. 5, p. 22; PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Universal Service Charge Rider (USR) – PPL Electric proposed to delete the Rate Schedule RTD (R) reference that was removed from the Tariff. PPL Electric also proposed to revise the filing date to December 21 of each year. Finally, the Company proposed to delete the sentence “The third quarter report shall be accompanied by a preliminary forecast of the USR charge for the next computation year.” PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Rate Stabilization Plan Rider – The Rate Stabilization Plan Rider expired on December 31, 2011. PPL Electric proposed to remove this Rider. PPL Electric St. 5, p. 22; PPL Ex. DAK 2. This proposal was unopposed and should be approved.

Competitive Transition Charge (CTC) Reconciliation Rider – The CTC Reconciliation Rider expired December 31, 2010. PPL Electric proposed to remove this Rider and all references to it from Rule 6 and 6A, Net Metering, and the Rate Schedules. PPL Electric St. 5, p. 22; PPL Ex. DAK 2. This proposal was unopposed and should be approved.

Renewable Energy Development (RED) Rider – The Net Metering for Renewable Customer-Generators Rider already addresses the eligibility, terms, and conditions applicable to all renewable customer-generators less than or equal to 10 kW. PPL Electric therefore has proposed to remove the RED Rider. PPL Electric St. 5, p. 22; PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Net Metering for Renewable Customer-Generators Rider – PPL Electric proposed two changes to its Net Metering tariff provisions for Renewable Customer-Generators. First, PPL Electric proposed to establish a limitation on the size of generator relative to the associated customer usage that would be eligible for net metering. Second, PPL Electric proposed to clarify that, for eligible customer-generators served under PPL Electric’s Time Of Use default service rate option, a weighted average of the on-peak and off-peak hour prices would be used to derive the Price to Compare for the purpose of compensating customer-generators for excess generation. PPL Electric St. 5, p. 25; PPL Electric Ex. DAK 2. Both SEF and Granger opposed PPL Electric’s proposal to limit the eligibility for net metering based on the size of the generator relative to the associated customer usage. PPL Electric addresses these parties’ concerns as discussed below.

Metering and Billing Credit Rider – PPL Electric proposed to update the Metering, Meter Reading, and Billing and Collection credits in accordance with the future test year cost of service data. PPL Electric St. 5, p. 23; PPL Electric Ex. DAK 2. The OCA raised several criticisms related to PPL Electric’s cost of service study, which the Company addresses as discussed above.

Demand Side Initiative Rider and Demand Side Response Rider – These experimental Riders expired on January 1, 2011. PPL Electric therefore proposed to remove these Riders. PPL Electric St. 5, pp. 22-23; PPL Electric Ex. DAK 5. This proposal was unopposed and should be approved.

Generation Supply Charge – The Generation Supply Charge rider expired on December 31, 2010. It has been replaced by the Generation Supply Charge — 1 and Generation Supply Charge — 2 riders. PPL Electric therefore proposed to eliminate the Generation Supply Charge rider. PPL Electric St. 5, p. 23; PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Generation Supply Charge – 1 – PPL Electric proposed to remove the RTS discount, which expired on December 31, 2011. The Company also proposed to revise the “E” term calculation to end one month prior to the computation quarter. PPL Electric Ex. DAK 2. This proposal was unopposed and should be approved.

Merchant Function Charge Rider (MFC) – Uncollectible accounts expense associated with generation supply and transmission service for default service customers is separated from the Company’s distribution rates and recovered through the MFC and included in its Price to Compare. The MFC percentages for the residential and small C&I customer classes have been calculated on the Company’s expected 2012 uncollectible accounts expense for those customer classes. Based thereon, PPL Electric proposed to change the MFC for the residential class from 1.80% to 2.23% and for small C&I customers from 0.10% to 0.23%. PPL Electric St. 8, pp. 29-30; PPL Electric St. 8-R, pp. 43-44; PPL Electric Ex. JMK 4. Dominion Retail and Direct Energy have opposed PPL Electric’s expected 2012 uncollectible accounts expense, which the Company addresses as discussed below.

Competitive Enhancement Rider (CER) –PPL Electric will estimate the total costs it expects to incur, on a calendar-year basis, to provide consumer education programs and competitive retail electricity market enhancement initiatives for all customers who receive distribution service from PPL Electric. The CER will be a Section 1307(e) cost recovery mechanism to recover the Company’s education and retail market enhancement-related costs. PPL St. 8, pp. 30-32; PPL Electric Ex. DAK 2. OCA, OSBA, and Direct Energy have raised various issues and concerns regarding the proposed CER, which the Company addresses as discussed below.

Reference to Rate Schedules RTD, LP-6, IS-P, IS-T, and GH-1 – PPL Electric proposed to eliminate the references to Rate Schedules RTD, LP-6, IS-P, IS-T, and GH-1 from the following riders, where applicable, because these rate schedules are being eliminated from the Tariff: Transmission Service Charge (TSC), Act 129 Compliance Rider, Generation Supply Charge – 1, Generation Supply Charge – 2, Merchant Function Charge Rider (MFC), Smart Meter Rider, as well as the Rider Matrix. PPL Electric St. 5, pp. 22-23; PPL Electric Ex. DAK 2. With the exception of the elimination of Rate Schedule RTD from the Tariff, which is addressed above, no parties opposed this proposal.

PPL Electric MB at 176-180.

**i. Net metering**

In its original filing, PPL Electric proposed two changes to its Net Metering tariff provisions for Renewable Customer-Generators. First, the Company sought to limit the size of generator relative to the associated customer usage that would be eligible for net metering. PPL Electric Ex. DAK-2 at 4. Second was a "clarification" that for eligible customer-generators served under the Time of Use default service rate option, a weighted average of the on-peak and off-peak hour prices would be used to derive the Price to Compare for the purpose of compensating customer-generators for excess generation. PPL Electric Stmt. 5r at 25; PPL Electric MB at 180-181. During the litigation, the Company changed the first proposal, following the opposition of SEF and Granger, to comply with the wording provided in the Commission's Final Order entered March 29, 2012 at Docket No. M-2011-2249441.

Granger opposed the as-filed proposal, as the Company proposed to limit the generation in all new net-metering applications to 110% of the customer-generator's connected load. PPL Stmt. 5 at 24-25, Exh. DAK-1. This was withdrawn by PPL Stmt. 5-RJ, which instead proposed a tariff revision that would incorporate language from the policy adopted by the Commission.[[59]](#footnote-59) This limits the 110% restriction to the business model where a third-party developer builds, owns, operates and maintains an alternative energy generation system on or near a customer's property and sells power and/or alternative energy credits to that customer. The Company's current proposal incorporates language from that Commission Order, and consequently, Granger does not oppose the proposal. Granger MB at 9.

The SEF supports the Company's revision and tariff change which proposes to incorporate the language from the Commission's Order as it is consistent with SEF Witness Costlow's testimony.

In its Reply Brief, SEF points out that the Company has provided no evidence to support an allegation that net metering customers cause PPL Electric to incur costs that support an increase in the customer charge and asks that this allegation be rejected. SEF RB at 1-2. SEF is correct, and this allegation is given no weight***.***

No party opposed the second proposal, which is to revise the tariff to use the weighted average of the on-peak and off-peak hour TOU prices to derive the Price to Compare. The stated purpose is to ensure that compensation for excess generation by TOU customer-generators more closely reflects their actual on-peak and off-peak usage and generation. PPL Electric MB at 180-182.

The revised net metering proposals should be approved.

**ii. Proposed Competitive Enhancement Rider**

The Company proposes a new rider to recover the costs of all customer education programs. It argues that the Commission and the appellate courts have held that an automatic adjustment clause is appropriate when the expenses to be recovered are substantial, subject to variation and beyond the control of the utility. PPL Electric MB at 206, citing *Popowsky v. Pa. Publ. Util. Comm'n,* 869 A.2d 1144, 11159 (Pa. Cmwlth. Ct. 2005) *appeal denied,* 586 Pa. 761, 895 A.2d 551 (2006); *Pennsylvania Industrial Energy Coalition v. Pa. Publ. Util. Comm' n,* 653 A.2d 1336 (Pa. Cmwlth, Ct. 1995); *Pa. Publ. Util. Comm'n v. Newtown Artesian Water Co.,* Docket Nos. R-2009-2117550, et al., 2010 Pa. PUC LEXIS 757 (Apr. 15, 2010); *Pa. Publ. Util. Comm'n v. Philadelphia Thermal Energy Corp.,* Docket No. R-91102-, 1991 Pa. PUC LEXIS 80 (May 3, 1991).

The Company avers that the costs of the mandates in the RMI and other proceedings will be more than $6 million annually, at least at the beginning, but they depend on the Commission's direction and are not within the control of the Company. The proposal is for the $5,482,220 for ongoing needs consistent with the Company's Consumer Education Plan, and amortization over two years of the cost of mailing the 2012 annual RMI postcard, $400,000. I note that should the Commission agree with my recommendation above, the costs of the Consumer Education Plan will end in 2012.

The OCA cautions the Commission that care must be taken to prevent double recovery of these costs. In addition, OCA reminds the Commission that it had recently held that the competitive enhancement costs should not be collected from ratepayers but from the EGSs.

OCA MB at 125, citing *Petition of FirstEnergy,* Docket No. P-2011-2273650 (Order of August 16, 2012) at 136. OCA recommends three safeguards: (1) that the allowed costs must conform to the standards in the Commission's May 10, 2007 Order in Docket No M-000061957; (2) that competitive enhancements costs incurred by PPL consistent with the Commission's directive, be collected from EGSs; and (3) that there be quantifiable assurances in place to prevent double recovery of these costs, such as through the CER and within the approved revenue requirement in this case.

OCA also recommends that the costs be allocated on a per kWh basis instead of per customer, reasoning that those with higher usage will benefit more from the information. OCA MB at 126. Costs are incurred on a per customer basis and should be allocated accordingly.

REG avers that Rate CER should be applied only to those customers and customer classes that benefit from the programs, activities, and enhancements funded by Rate CER. As customers already shopping know that they can shop and that Rate CER provides an incentive to customers to shop to the extent that it is imposed on them, Rate CER is best imposed on non-shopping customers to provide them an incentive to shop and should not be imposed upon customers who have already selected alternative suppliers. REG MB at 6; RB at 1.

Throughout this proceeding, the EGS parties have argued that all customers benefit from a robust competitive market, and therefore, nonshopping customers should pay for the competitive enhancements that the Company proposes here. As REG states, the Rate CER is intended to provide an incentive to shop, and therefore, already-shopping customers do not need the incentive.

However, closer scrutiny of this argument reveals that the real goal is to entice customers away from default service, not necessarily to shop for the best deal. PPL Electric has proposed to implement a nonbypassable CER to recover costs of the Consumer Education Plan and any retail market enhancement costs not recovered from EGSs.

PPLICA limits its argument to cautioning the Commission to ensure that the Company's costs are not duplicated in multiple education programs. PPLICA MB at 21. PPLICA notes further that the Company's proposal to recover costs of retail market enhancement programs from the EGSs that benefit from them is consistent with the Commission's RMI Final Order and therefore, PPLICA supports this proposal. PPLICA MB at 21.

Regarding recovery of costs, PPLICA believes that the costs allocated to a customer class should be recovered per customer, not per kWh, as proposed by OCA. This is contrary to cost causation principles. PPLICA MB at 23. PPLICA does not oppose approval of the proposal to recover CER costs through a fixed monthly customer charge.

I recommend that the CER be approved, and the costs incurred by the Company in implementing the retail market enhancement programs, including consumer education costs not recoverable from the EGSs, be recovered using the CER. As all customers benefit from the robust competitive market, then all customers should bear the costs involved in developing it, on a per customer basis.

**c. Purchase of Receivables**

PPL Electric purchases, at a discount, the accounts receivable of EGS customers who participate in the POR program. The discount is composed of an uncollectible accounts percentage factor, and a development, implementation, and administrative factor. The Company proposes to increase the uncollectible accounts expense factor by 23.89% for residential customers to 2.23%, and 56.52% for small commercial customers, to 0.23%.

Uncollectible expenses are those which result from customers not paying for service and the amount of the non-payment is written off. Cost of uncollectible expense is recovered from default customers through the Merchant Function Charge and from shopping customers through the discounted rate at which it purchases the account receivable for the POR program.

In the ordinary course of business, the entity rendering the service is responsible for the costs and actions associated with billing and collection of payments, and also bears the risk of non-payment or late payments. Under a POR program, the EGSs sells its accounts receivable to PPL and receives immediate payment for the amount due minus a discount meant to reflect collection risk and the time value of money. "A POR program therefore allows the seller of the receivable to receive payment sooner and avoid the costs and risks associated with collecting any delinquent amounts owed by the customer." PPL Electric MB at 184.

The existing POR program was authorized by the Commission's Order in *Petition of PPL Utilities Corporation Requesting Approval of a Voluntary Purchase of Accounts Receivables Program and Merchant Function Charge*, Docket No. P-2009-2129502 (Opinion and Order entered November 19, 2009), which approved a settlement of the following factors: (1) the discount rate for residential service was 1.37%, consisting of an uncollectible accounts expense percentage factor of 1.32% and a POR administrative factor of .05%; (2) in order to participate, an EGS would sell all of its residential customer accounts receivables to the Company; (3) participating EGSs agreed to not reject new customers based on credit-related issues and would not require a deposit; (4) budget billing would be available to customers of participating EGSs; (5) for small commercial and industrial shopping customers, the discount rate was 0.17%, reflecting an uncollectible accounts expense percentage factor of 0.12% and a POR administrative factor of 0.05%. The percentages were increased in the 2010 base rate case, *Pa. PUC v. PPL Electric Utilities Corporation,* Docket No. R-2010-2161694 (Order entered December 21, 2010), 2010 Pa. PUC LEXIS 2001.

The original Opinion and Order contains specific language which PPL Electric relies upon here, including its claim that the POR Program, which was filed in response to the Commission's Retail Markets Order, was voluntary. The Company stated in that proceeding that it did not believe that the Commission had the authority to require it to purchase an EGS' receivables, and the Commission agreed, recognizing that the express provisions of the Public Utility Code prohibit the Commission from requiring an EDC to purchase the EGS' receivables. 66 Pa. C.S.§ 2807(c)(3).[[60]](#footnote-60)

The Company bases its proposed numbers on its actual write-offs from 2011, which were approximately $40 million. PPL Electric MB at 187; PPL Electric Stmt. 8-R at 43. To calculate the amount sought here, PPL Electric used its proposed 2012 budget amount, which is the sum of projected write-offs and the projected change in the reserve for doubtful accounts for 2012. PPL Electric MB at 187; PPL Electric Stmt. 8-R at 44.

Direct Energy opposes the Company's proposal and recommends instead that PPL Electric be permitted to recover 100% of its uncollectible accounts expense by implementing a non-bypassable/non-reconcilable charge applicable to all customers. In the alternative, Direct Energy recommends modifying the Company's proposal by reducing the discount rate to reflect the amount of late payment charges that the Company collects and which offset its net uncollectible accounts expense; and reducing the discount factor by an administrative cost credit to return to the EGSs the amounts that have been collected through the administrative cost adder but which the Company does not track.

Direct Energy avers that the Company proposal must be rejected for three reasons, the first of which is that there is no record basis to support allocation of the proposed uncollectible accounts expense percentage to generation service customers.

While PPL Electric has proposed that shopping and default customers pay at the same percentage level, it has not provided evidence to support a finding that this is just and reasonable. In fact, the Company admitted that it does not track write-offs by the shopping/default categories. Dir.ES MB at 12, citing Tr. 404. While Direct Energy points out that it is possible that one category may be more reliable in paying bills than the other, and that the shoppers may be unfairly charged here, it is just as likely that the default customers are effectively subsidizing shopping customers.

However, the point is well-taken, and the Company should be required to track uncollectibles by default and shopping customers separately, and the correct percentage can be discerned from there. The proposed percentage is supported by the past uncollectibles in total, but there is no calculation of which uncollectibles are from default customers and which are from shopping customers. This is not consistent with the terms of the settlement from which the POR program was conceived:

25. The Company will monitor individual EGS uncollectible percentages for small C&I customers pursuant to Section12.9.2.6 of the tariff supplement provided in Appendix A and will adjust the discount rate for an individual EGS based upon the provisions contained therein.

*Petition of PPL Electric Utilities Corporation Requesting Approval of a Voluntary Purchase of Accounts Receivables Program and Merchant Function Charge,* P-2009-2129502 (Opinion and Order entered November 19, 2009)

The second reason given by Direct Energy is that the Company proposal will stall development of a fully robust competitive retail market. Direct Energy states that "the current level of competition in PPL's service territory is good but is could be much better. The current levels of shopping need not only be sustained but increased in order to meet the Commonwealth's goal of a fully competitive retail electric market. PPL's service territory presents the best opportunity to do that, but only if the Commission continues to remain vigilant about properly allocating costs to EGSs." Dir.ES MB at 14 (footnotes omitted).

Direct Energy argues that the levels of uncollectible discount that PPL Electric is proposing to charge through the POR program will have a significant negative effect on the development of competition because EGSs cannot administer their own programs efficiently and inexpensively and have no real choice but to rely on the Company. Dir.ES MB at 15.

The Company denies that its increase will have a negative effect on the competitive market. While Direct Energy and Dominion argue that the EGSs would have to bear the difference in cost until the expiration of existing fixed-price contracts, the Company points out that there should have been no reasonable expectation that the discount rate would remain static indefinitely. Such risk, the Company argues, was willingly undertaken by the EGSs, is a business risk, and cannot be used to shift the risk of doing business as an EGS to PPL Electric and its customers. PPL Electric RB at 105-106.

In addition, the Commission accepted RESA's argument in the 2010 rate case that PPL's all in/all out POR program constituted a barrier to competitive markets and directed the Company to allow EGSs that are participating in its POR program to bill customers separately. This served two purposes: first, it recognized that there are EGSs which want to bill customers separately; and second, it reflects PPL Electric's tacit acknowledgement that, while the program itself cannot be ordered, once it does exist, the Commission can exercise control over its terms.

Direct Energy posits that the Company's failure to properly support its own proposal opens the door for the Commission to consider the Direct Energy alternative, which is to collect total *projected* uncollectible accounts expense through a non-bypassable charge for all distribution customers. This eliminates the need for determining the actual uncollectible expense. This approach, Direct Energy argues, is superior to the Company's because it is consistent across shopping lines and does not contain the possibility of shoppers subsidizing default customers. Dir.ES MB at 18.

In actuality, it is simply less unfair in its inherent unfairness, as it does not require the Company to determine the actual amount of its uncollectible expenses in order to recover it. The actual amount of the uncollectible expenses is required in order to fairly charge customers the correct amount. The Company states that its proposal is based on its actual uncollectible expenses. It should be directed to take the next step and determine that amount for shoppers and to determine that amount for default customers, and to collect it accordingly.

Further PPL Electric argues persuasively that the dual MFC/POR method appropriately unbundles the uncollectibles charge and properly assigns risk of nonpayment, PPL Electric MB at 189-193, and that Direct Energy's proposal to refund all amounts that PPL Electric has received under the administrative component of the POR should be rejected as impermissible retroactive ratemaking, PPL Electric MB at 193. Direct Energy and Dominion have not sustained their burden of proving that their alternatives are appropriate choices for the Commission to order in this case. *See Pa. PUC v. Metropolitan Edison Company, et al.,* Docket No. R-00061366, 200 Pa. PUC LEXIS 5 at 111-12 (January 11, 2007); *Pa. PUC v. Philadelphia Gas Works,* Docket Nos. R-00061931, et al., 2007 Pa. PUC LEXIS at 165-168 (September 28, 2007).

PPL Electric argues that the Commission has no authority to direct a change in its POR program due to its voluntary nature. However, as Direct Energy points out, it is a tariffed program, which results in the requirement that it be just and reasonable. DES RB at 6-7. While the Commission has acknowledged that it cannot direct that PPL Electric implement a POR plan, it certainly can tell PPL Electric if its tariffed program can be implemented. This proposed increase in the POR discount rate should be delayed until the Company provides data indicating the proportions of uncollectibles attributable to default customers and to shopping customers, to support the proper discount rate.

Direct Energy and Dominion claim that PPL Electric should be required to use late payment charges to reduce the POR and MFC percentages. The Company responds that late payment charges are paid, and are, therefore, not uncollectible but are revenue, as reflected in Company accounting for decades and repeatedly approved by the Commission. PPL Electric MB at 188; PPL Electric Stmt. 8-RJ at 8. In addition, the Company points out that late payment charges are used to reduce overall distribution of revenue requirement for customer rate classes that bear the working capital requirement associated with overdue accounts receivable. Granting this request would result in double counting. PPL Electric MB at 188. Therefore, should the request be granted, the late payment fees would need to be split between the POR and MFC customers, accompanied by an adjustment in base rate revenues – which would increase rates for all distribution customers. PPL Electric 8-RJ; PPL Electric MB at 189.

Late payment fees are presently added to revenues, and that is where they should remain.

**V. CONCLUSIONS OF LAW**

1. Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission. 66 Pa. C.S. § 1301.

2. The burden of proving the justness and reasonableness of every element of the utility's rate increase rests solely upon the public utility. 66 Pa. C.S. § 315(a); *Lower Frederick Twpl. V. Pa. Publ. Util. Comm'n*, 409 A.2d 505 (Pa. Cmwlth. Ct. 1980).

3. While the burden of proof remains with the public utility throughout the rate proceeding, the Commission has stated that where a party proposes an adjustment to a ratemaking claim of a utility, the proposing party bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *Pennsylvania Pub. Util. Comm’n v. Aqua Pennsylvania, Inc*., Docket No. R-00072711 (Commission Opinion and Order entered July 17, 2008).

4. The Commission must consider the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates in exchange for customers paying rates for service, which include the cost of utility plant in service and a rate of return. 66 Pa.C.S. § 523.

5. In exchange for the utility’s provision of safe, adequate and reasonable service, the ratepayers are obligated to pay rates which cover the cost of service which includes reasonable operation and maintenance expenses, depreciation, taxes and a fair rate of return for the utility’s investors. *Pa. Pub. Util. Comm’n v. Pennsylvania Gas & Water Co.,* 61 Pa. PUC 409, 415-16 (1986); 66 Pa.C.S. § 1501.

6. The Commission has the discretionary authority to deny a proposed rate increase, in whole or in part, if the Commission finds that the service rendered by the public utility is inadequate. 66 Pa.C.S. § 526(a).

7. In proving that its proposed rates are just and reasonable, a public utility need not affirmatively defend every claim it has made in its filing, even those which no other party has questioned. Allegheny Center Assocs. v. Pennsylvania Pub. Util. Comm’n., 131 Pa.Cmwlth. 352, 359, 570 A.2d 149, 153 (1990) (citation omitted). *See also,* Pennsylvania Pub. Util. Comm’n. v. Equitable Gas Co., 73 Pa. P.U.C. 310, 359 – 360 (1990).

8. The mere rejection of evidence contrary to that adduced by the public utility is not an impermissible shifting of the evidentiary burden. *United States Steel Corp. v. Pennsylvania Pub. Util. Comm’n.*, 72 Pa. Cmwlth. 171, 456 A.2d 686 (1983).

9. When parties have been ordered to file briefs and fail to include all the issues they wish to have reviewed, the issues not briefed have been waived. *Jackson v. Kassab*, 2002 Pa.Super. 370, 812 A.2d 1233 (2002), *appeal denied*, *Jackson v. Kassab*, 573 Pa. 698, 825 A.2d 1261 (2003), *Brown v. PA Dep’t of Transportation*, 843 A.2d 429 (Pa.Cwlth. Ct. 2004), *appeal denied*, 581 Pa. 681, 863 A.2d 1149 (2004).

10. The Commission is not required to consider expressly and at length each contention and authority brought forth by each party to the proceeding. *University of Pennsylvania v. Pennsylvania Pub. Util. Comm’n.*, 86 Pa. Cmwlth. 410, 485 A.2d 1217 (1984). “A voluminous record does not create, by its bulk alone, a multitude of real issues demanding individual attention . . . .” *Application of Midwestern Fidelity Corp.*, 26 Pa. Cmwlth. 211, 230 fn.6, 363 A.2d 892, 902, fn.6 (1976).

11. A Commission decision is adequate where, on each of the issues raised, the Commission was merely presented with a choice of actions, each fully developed in the record, and its choice on each issue amounted to an implicit acceptance of one party's thesis and rejection of the other party's contention. *Popowsky, et al. v. Pa. Publ. Util. Comm'n* , 550 Pa. 449, 706 A.2d 1197 (1997), 1997 Pa. LEXIS 2756.

12. The standard formula for determining a utility's base rate revenue requirement is:

RR = E + D + T + (RB x ROR)

RR: Revenue Requirement

E: Operating Expense

D: Depreciation Expense

T: Taxes

RB: Rate Base

ROR: Overall Rate of Return

I&E Stmt. 1 at 4-5; I&E MB at 75 fn 158.

13. In analyzing a proposed general rate increase, the Commission determines a rate of return to be applied to a rate base measured by the aggregate value of all the utility’s property used and useful in the public service. The Commission determines a proper rate of return by calculating the utility’s capital structure and the cost of the different types of capital during the period in issue. The Commission is granted wide discretion, because of its administrative expertise, in determining the cost of capital. *Equitable Gas Co. v. Pennsylvania Pub. Util. Comm’n*., 45 Pa. Cmwlth. 610, 405 A.2d 1055 (1979).

14. The rate base is the value of the property of the utility that is used and useful in providing utility service.*Pennsylvania Power Company v. Pa. Publ. Util. Comm'n,* 561 A.2d 43, 47 (Pa. Cmwlth. Ct. 1989). In the area of adjustment to rate base, the Commission has wide discretion. *Pennsylvania Power & Light Company v. Pa. Publ. Util. Comm'n,* 516 A.2d 426 (Pa. Cmwlth. Ct. 1985); *UGI Corp. v. Pa. Publ. Util. Comm'n,* 410 A.2d 923, 929 (Pa. Cmwlth Ct. 1980)(UGI case); *Duquesne Light Co. v. Pa. Publ. Util. Comm'n,* 174 Pa. Superior Ct. 62, 69-70, 99 A.2d 61, 69 (1953). However, the adjustments must be supported by sound reasons. *Philadelphia Suburban Water Co. v. Pa. Publ. Util. Comm'n,* 394 A.2d 1063 (Pa. Cmwlth. Ct. 1978).

15. The utility management discretion doctrine holds that as a general matter, utility management is in the hands of the utility, and the Commission may not interfere with lawful management decisions, including decisions related to the necessity and propriety of operating expenses, unless on the basis of record evidence, it finds an abuse of the utility's managerial discretion. *Emporium Water Company v. Pa. Publ. Util. Comm'n,* 955 A.2d 456, 465 (Pa. Cmwlth. Ct. 2008); *National Fuel Gas Distribution Corp. v. Pa. Publ. Util. Comm'n,* 464 A.2d 546, 559 (Pa. Cmwlth. Ct. 1983).

16. The law is clear that a utility is entitled to recover its reasonably incurred expenses. *UGI Corp. v. Pa. Publ. Util. Comm'n,* 410 A.2d 923 (Pa. Cmwlth. 1980). Expenses include such items as the cost of operations and maintenance (labor, fuel and administrative costs, e.g.), depreciation and taxes. *Pennsylvania Power Company v. Pa. Publ. Util. Comm'n,* 561 A.2d 43, 47 (Pa. Cmwlth. Ct. 1989).

17. To require a sharing of expense with shareholders is to deny that portion in a rate case, which is simply not permitted under case law. *Butler Township Water Co. v. Pa. Publ. Util. Comm'n,* 473 A.2d 219 (Pa. Cmwlth. Ct. 1984); *T.W. Phillips Gas and Oil Co. v. Pa. Publ. Util. Comm'n*, 474 A.2d 355 (Pa. Cmwlth. 1984).

18. The Commission has approved incentive compensation programs in numerous prior rate cases. *See, e.g.*, *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 2008 Pa. PUC LEXIS 50, Docket No. R-00072711 (July 31, 2008); *Pa. P.U.C. v. Duquesne Light Co.*, 63 Pa. PUC 337, 1987 Pa. PUC LEXIS 342 (March 10, 1987); *Pa. P.U.C. v. PPL Gas Utilities Corporation*, R-00061398, p. 40 (Feb. 9, 2007)"(*PPL Gas*).

19. The Commission has no authority to permit, in the rate-making process, the inclusion of hypothetical expenses not actually incurred. When it does so, as it did in this case, it is an error of law subject to reversal on appeal. *Barasch v. Pa. Publ. Util. Comm'n,* 493 A.2d 653, 655 (Pa. 1985)

20. It is the historical filings, not the actual intentions of the utility, which will guide the determination of the normalization period. *Pa. Publ. Util. Comm'n v. City of Lancaster,* R-2010-2179103, et al. (Opinion and Order entered July 14, 2011), 2011 Pa. PUC LEXIS 1685; *Pa. Publ. Utility Comm'n v. Metropolitan Edison Company,* R-00061366, et al. (Opinion and Order entered January 4, 2077), 2007 Pa. PUC LEXIS 5.

21. The Commission is charged with the duty of protecting the rights of the public. As a general rule, a public utility, whose facilities and assets have been dedicated to public service, is entitled to *no more than* a reasonable opportunity to earn a fair rate of return on shareholder investment. It is the function of the commission in fixing a fair rate of return to consider not only the interest of the utility but that of the general public as well. The commission stands between the public and the utility.” *City of Pittsburgh v. Pa. PUC*, 126 A.2d 777, 785 (Pa. Super. 1956).

22. Rate of return is the amount of money a utility earns, over and above operating expenses, depreciation expense, and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the ‘return’ are interest on long-term debt, dividends on preferred stock, and earnings on common equity. In other words, the return is the money earned from operations which is available for distribution among the various classes of contributors of money capital. *Pa. PUC v. Philadelphia Suburban Water Co.,* 71 Pa. PUC 593, 623 (1989).

23. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management…to raise the money necessary for the proper discharge of public duties. *Bluefield Waterworks & Improvement Co. v. Public Service Comm’n of West Virginia,* 262 U.S. 679 (1923).

24. Whether a particular rate is unjust or unreasonable will depend to some extent on what is a fair rate of return given the risks under a particular rate setting system, and on the amount of capital upon which the investors are entitled to earn that return.

*Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989). I

25. Determination of a fair rate of return for a public utility requires the exercise of informed judgment based upon an evaluation of the particular facts presented in each proceeding. There is no one precise answer to the question as to what constitutes the proper rate of return. The interests of the Company and its investors are to be considered along with those of the customers, all to the end of assuring adequate service to the public at the least cost, while at the same time maintaining the financial integrity of the utility involved. *Pa. Publ. Util. Corp. v. Pennsylvania Power Co*., 55 Pa. PUC 552, 579 (1982). See also *Pa. PUC v. National Fuel Gas Dist. Corp*., 73 Pa. PUC 552, 603-605 (1990).

26. If a utility's actual capital structure is within the range of a similarly situated barometer group of companies, rates are set based on the utility's actual capital structure. Only if the capital structure is atypical (outside of the range of the barometer group), should a hypothetical capital structure be used to set rates for a utility. *Pa. Publ. Util. Comm'n v. City of Lancaster – Water,* 197 PUR 4th 156, 161-162, Docket No. R-00984567, et al. (Order entered September 22, 1999); *Pa. Publ. Util. Comm'n v. City of Bethlehem,* 84 Pa PUC 275, 304 (1995); *Carnegie Natural Gas Co. v. Pa. Publ. Util. Comm'n,* 433 A.2d 938, 940 (Pa. Cmwlth. 1981).

27. Establishment of a rate structure is an administrative function peculiarly within the expertise of the Commission. *Emporium Water Company v. Pa. Publ. Util. Comm'n,* 955 A.2d 456, 461 (Pa. Cmwlth. Ct. 2008); *City of Lancaster v. Pa. Publ. Util. Comm'n*, 769 A.2d 567, 571-72 (Pa. Cmwlth. Ct. 2001). The question of reasonableness of rates and the difference between rates in their respective classes is an administrative question for the Commission to decide. *Pennsylvania Power & Light Co. v. Pa. Publ. Util. Comm'n,* 516 A.2d 426 (Pa. Cmwlth. Ct. 1986); *Park Towne v. Pa. Publ. Util. Comm'n,* 43 A.2d 610 (1981).

28. When a utility files for a rate increase, it must file a cost-of-service study (COSS) assigning to each customer class a rate based upon operating costs that it incurred in providing that service. 52 Pa. Code § 53.53; *Lloyd v. Pa. Publ. Util. Comm’n,* 904 A.2d 1010 (Pa. Cmwlth. 2006) *appeal denied* 591 Pa. 676, 916 A.2d 1104, fn. 10 (2007).

29. Historically, the Commission has primarily relied on the DCF methodology in determining the proper cost of common equity. *See Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, 71 Pa. PUC 593, 623-632 (1989); *Pennsylvania Public Utility Commission v. Western Pennsylvania Water Company*, 67 Pa. PUC 529, 559-570 (1988); *Pennsylvania* *Public Utility Commission v. Roaring Creek Water Company*, 150 PUR4th 449, 483-488 (1994); *Pennsylvania Public Utility Commission v. York Water Company,* 75 Pa. PUC 134, 153-167 (1991); *Pennsylvania Public Utility Commission v. Equitable Company*, 73 Pa. PUC 345-346 (1990).

30. The DCF method is the preferred method of analysis to determine a market based common equity cost rate.  *Pa. PUC v. Pennsylvania American Water* *Company*, 99 Pa. PUC 38, 42 (2004) *aff’d on other grounds, Popowsky v. Pa. PUC*, 868 A.2d 606 (Pa. Commw. Ct. 2004); *accord Pa. PUC v. Aqua Pa, Inc.,* 99 Pa. PUC 204, 233 (2004).

31. The basic factor in allocating revenue is to have the rates reflect the cost of service. *Lloyd v. Pa. Publ. Util. Comm'n,* 904 A.2d 1010, 1020 (Pa. Cmwlth. Ct. 2006).

**VI. ORDER**

THEREFORE,

IT IS RECOMMENDED:

1. That PPL Electric Utilities Corporation shall not place into effect the rules, rates and regulations contained in Supplement No. 118 to Tariff Electric- Pa. P.U.C. No. 201.

2. That PPL Electric Utilities Corporation is authorized to file tariffs, tariff supplements or tariff revisions containing rates, rules and regulations, consistent with the findings herein, to produce revenues not in excess of $844,255,000 or an increase over present revenues of $63,830,000.

3. That PPL Electric Utilities Corporation is authorized to establish a Competitive Enhancement Rider.

4. That PPL Electric Utilities Corporation tariffs, tariff supplements and/or tariff revisions may be filed on less than statutory notice, and pursuant to the provisions of 52 Pa. Code §53.1, *et seq.*, and 53.101, may be filed to be effective for service rendered on and after January 1, 2013.

5. That PPL Electric Utilities Corporation shall file detailed calculations with its tariff filing, which shall demonstrate to the parties' satisfaction that the filed tariffs with the adjustments comply with the provisions of the final Commission Order.

6. That PPL Electric Utilities Corporation shall allocate the authorized increase in operating revenue to each customer class and rate schedule within each in the manner prescribed in the Final Commission Order.

7. That assessment of interest on Competitive Enhancement Rider overcollections and undercollections shall be calculated at the statutory rate provided in 66 Pa. C.S. § 1308.

8. That PPL Electric Utilities Corporation shall develop and submit for approval a plan for establishment of a storm damage reserve account and shall serve its proposed plan on the parties to this docket within three months of the entry of the final Commission Order in this docket.

9. That PPL Electric Utilities Corporation shall determine the correct amount of uncollectible expenses incurred in 2012 and the break-down of expenses between shopping and default service customers.

10. That PPL Electric Utilities Corporation shall submit the findings and supporting data for the uncollectible expenses of shopping and default service customers within ninety days of the Final Commission Order in this docket with a request to use the correct numbers in its Purchase of Receivables Program.

11. That if PPL Electric Utilities Corporation does not comply with ordering paragraph 10, the percentage rates currently in effect in its Purchase of Receivables Program shall remain in effect.

12. That the request of the Commission on Economic Opportunity to increase the Low Income Usage Reduction Program's budget at this time is denied.

13. That PPL Electric Utilities Corporation may recover its consumer education expenses incurred through 2012 in compliance with the approved plan in docket no. M-2008-2032279.

14. That the investigation at docket no. R-2012-2290597 is terminated.

15. That the complaints docketed at C-2012-2300266, C-2012-2301063, and C-2012-2306728 are considered satisfied in part and dismissed in part consistent with this Order.

16. That the complaints docketed at C-2012-2300402, C-2012-2313283, C‑2012-2299539, C-2012-2304870, C-2012-2298593, C-2012-2328596 and C-2012-2299335 are hereby dismissed and the dockets shall be marked closed.

Dated: October 19, 2012 \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Susan D. Colwell

Administrative Law Judge

**APPENDIX A**

**LIST OF TESTIMONY AND EXHIBITS BY PARTY**

**PARTY WITNESS STATEMENT/EXHIBIT**

PPL Electric Utilities Corporation Gregory Dudkin 1

Gary L. Banzhoff 2, GLB-1 through 5

2-R, GLB-6 through 8

2-RJ, GLB-9 and 10

Denise A. Cunningham 3

3-R, DAC-1 and 2

David R. Woodruff 4, DRW-2

4-R, DRW 1(rev.) and 3

Douglas A. Krall 5, DAK-1, 1A, 2 and 3

5-R, DAK-4 and 5

5-RJ

Thomas C. Stathos 6, TCS-1

6-R, TCS-2

Bethany L. Johnson 7

7-R, BLJ-1-3

Joseph M. Kleha 8, JMK-1-4

8-R, JMK-5

8-RJ-1, JMK-6 and 7

8-RJ-2

Timothy R. Dahl 9, 9-R, 9-RJ

Russell R. Clelland 10, 10-R, 10-RJ

Paul R. Moul 11, 11-R, 11-RJ

Julie M. Cannell 12

12-R, JMC-1 and 2

John J. Spanos 13, JJS-1 and 2

Terry Novatnack 14-R, TN-1

14-RJ, TN-2

PPL Exhibit 1 is the filing, with the various parts sponsored by various witnesses, listed in more detail in the transcript at page \_\_\_\_\_\_\_\_\_\_\_\_\_\_

PPL Cross exhibits 1 and 2

Commission on Economic Opportunity (CEO) Eugene M. Brady 1, 1-S

Direct Energy Ronald M. Cerniglia 1, 1-SR

Dominion Retail Thomas J. Butler 1, 1-SR

Granger Joel M. Zylstra 1, 1-SR

Investigation & Enforcement Emily Sears 1, 1-SR

Dorothy Morrissey 2, 2-SR

Jeremy B. Hubert 3, 3-SR

Amanda Gordon 4

I&E cross exhibits 1-7; 9-13

OCA Richard J. Koda 1(rev.), 1-SR

Stephen G. Hill 2, 2-SR

Glenn A. Watkins 3, 3-R, 3-SR

Roger D. Colton 4, 4-SR

OCA cross exhibits 1-3

OSBA Robert D. Knecht 1, 2, 3

PPLICA Richard Baudino 1-SR

Sustainable Energy Fund John Costlow 1, 1-SR

APPENDIX B

TABLES WILL BE A SEPARATE DOCUMENT ON THE WEBSITE

1. By letter received June 19, 2012, Mr. Leventry indicated that he did not want to be involved in the litigation and asked that he be removed from the service list. [↑](#footnote-ref-1)
2. Mr. Marczak's contact information was provided to the Office of Small Business Advocate. [↑](#footnote-ref-2)
3. A PPL Electric service representative spoke with Mrs. Strawbridge regarding her eligibility for the Company's programs. See PPL Electric Stmt. 9-R at 28-29. [↑](#footnote-ref-3)
4. 1 Pa.C.S. §1922(1), *PA Financial Responsibility Assigned Claims Plan v. English*, 541 Pa. 424, 64 A.2d 84 (1995). [↑](#footnote-ref-4)
5. I&E St. 2 at 28. [↑](#footnote-ref-5)
6. I&E St. 2-SR at 20-21. [↑](#footnote-ref-6)
7. I&E RB fn 78 reads: PPL Stmt. 2-RJ at 5. [↑](#footnote-ref-7)
8. Note that in presenting its 2004 rate case, PPL Electric had an A minus rating, which it sought to retain at that time. Recommended Decision of Administrative Law Judge Allison K. Turner at 94. [↑](#footnote-ref-8)
9. PPL St. 11 at 4-5. [↑](#footnote-ref-9)
10. As noted above, PPL Electric adjusted its long-term debt cost to reflect the results of the Company’s actual issuance of $250 million of long–term debt which reduced its weighted average long-term debt cost to 5.50%. See PPL Electric MB at 91. [↑](#footnote-ref-10)
11. I&E St. 1 at 24. [↑](#footnote-ref-11)
12. PPL St. 11 at 25. [↑](#footnote-ref-12)
13. I&E St. 1 at 40-41. [↑](#footnote-ref-13)
14. PPL St. 11 at 26. [↑](#footnote-ref-14)
15. I&E St. 1 at 24-25. [↑](#footnote-ref-15)
16. In his direct testimony, Mr. Hill explained in detail why projected earnings growth rates should not be used as the primary source of a DCF growth rate, as Mr. Moul has done in this proceeding. OCA St. 2 at 33-37. [↑](#footnote-ref-16)
17. *Pa. P.U.C. v. Blue Mountain Consolidated Water Co*., 1982 WL 213115 (Pa. P.U.C.), at 1 (emphasis added). [↑](#footnote-ref-17)
18. *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-00072711, (Order entered July 31, 2008) at 38. [↑](#footnote-ref-18)
19. *Pa. P.U.C. v. Metropolitan Edison Co.*, Docket No. R-00061366, p. 34 (Order entered January 11, 2007) at 34. [↑](#footnote-ref-19)
20. *Pa. P.U.C. et al. v. City of Lancaster – Bureau of Water*, Docket No. R-2010-2179103 (Order entered July 14, 2011) at 79. [↑](#footnote-ref-20)
21. Beta reflects the degree to which utility stock prices vary in accordance with the general stock market and is a measure of the relative lower risk of utilities as compared to the total market which by definition has a beta of 1.0. PPL Electric St. 11, Appendix H, p. H-3. [↑](#footnote-ref-21)
22. I&E MB fn 232: I&E St. 1 at 31-37. The presentation of the CAPM analyses is purely for Commission consideration of an alternative means of analyzing financial data. For the reasons fully set forth in Ms. Sears’ direct testimony, I&E supports the DCF as the superior methodology for conducting a rate of return analysis in a utility ratemaking proceeding. [↑](#footnote-ref-22)
23. I&E St. 1 at 19-23, 38-39. [↑](#footnote-ref-23)
24. I&E MB fn 220: I&E St. 1 at 55, citing Dr. Annie Wong, “Utility Stocks and the Size Effect: An Empirical Analysis,” *Journal of Midwest Finance Association*, 1993, at 95-101 (emphasis added), reproduced in I&E Ex. I, Sch. 15. [↑](#footnote-ref-24)
25. I&E MB fn 221: PPL St. 11 at 8-9. [↑](#footnote-ref-25)
26. I&E MB fn 223: I&E St. 2 at 58; Tr. at 236-37. [↑](#footnote-ref-26)
27. I&E MB fn 224: I&E St. 2 at 58; I&E Cross-Examination Ex. 2; Tr. at 231-32, 447-48. [↑](#footnote-ref-27)
28. I&E MB fn 225: *See Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-00049255, at 19-23. [↑](#footnote-ref-28)
29. I&E MB fn. 226: PPL St. 11 at 10-11. [↑](#footnote-ref-29)
30. I&E MB fn 226: Tr. at 445. [↑](#footnote-ref-30)
31. I&E MB fn 227: I&E St. 1 at 58-60. [↑](#footnote-ref-31)
32. I&E MB fn 228: Tr. at 292. [↑](#footnote-ref-32)
33. I&E MB fn 229: I&E Cross Examination Ex. 6 at 9. [↑](#footnote-ref-33)
34. I&E MB fn 330: Tr. at 293-94. [↑](#footnote-ref-34)
35. I&E MB fn 231: I&E St. 2 at 61. [↑](#footnote-ref-35)
36. I&E St. 1 at 19-23, 38-39. [↑](#footnote-ref-36)
37. I&E Cross-Examination Ex. 1; Tr. 222-23. [↑](#footnote-ref-37)
38. PPL Ex. PRM-1 at 27, Sch. 36. [↑](#footnote-ref-38)
39. I&E St. 1 at 52-53. [↑](#footnote-ref-39)
40. PPL St. 11 at 3-6. [↑](#footnote-ref-40)
41. I&E St. 1 at 37. [↑](#footnote-ref-41)
42. PPL MB at 91. [↑](#footnote-ref-42)
43. I&E St. 1 at 80; I&E Ex. 1, Sch. 1 at 1. [↑](#footnote-ref-43)
44. I&E MB fn 146: Use of Ms. Morrissey’s recommended uncollectible expense adjustment is subject to change dependent upon the final revenue increase approved as well as the acceptance of I&E’s recommended uncollectible expense rate, addressed above. Using the Company’s claimed uncollectible rate of 2.23% and revenue increase request, the resulting adjustment would result in a $138,000 reduction. [↑](#footnote-ref-44)
45. I&E MB fn 147: I&E St. 2 at 46-48. [↑](#footnote-ref-45)
46. I&E MB fn 148: PPL St. 8-R at 36-37. [↑](#footnote-ref-46)
47. I&E MB fn 149: Tr. at 171-72. [↑](#footnote-ref-47)
48. I&E St. 2 at 49-50. [↑](#footnote-ref-48)
49. PPL St. 8-R at 38. [↑](#footnote-ref-49)
50. I&E St 2-SR at 56-57. [↑](#footnote-ref-50)
51. *Pa. P.U.C. v. PPL Electric Utilities Corporation,* Docket No. R-00049255 (Order entered December 22, 2004), Slip Opinion at 54. [↑](#footnote-ref-51)
52. *Pa. P.U.C. v. PPL Electric Utilities Corporation,* Docket No. R-00072155 (Order entered December 6, 2007). [↑](#footnote-ref-52)
53. I&E St. 2 at 51-52. [↑](#footnote-ref-53)
54. PPL St. 8-R at 33-35; PPL St. 8-RJ at 6-7. [↑](#footnote-ref-54)
55. I&E St. 2-SR at 58. [↑](#footnote-ref-55)
56. For a list and description of the rate classes served by the Company, see OSBA MB at 5-6, quoting OSBA Stmt. 1 at 4-5. [↑](#footnote-ref-56)
57. I&E St. 3 at 11-14; I&E Ex. 3, Sch. 2, p. 2. [↑](#footnote-ref-57)
58. Tr. at 541-42. [↑](#footnote-ref-58)
59. *Net Metering – Use of Third Party Operators*, Docket No. M-2011-2249441 (entered March 29, 2012). [↑](#footnote-ref-59)
60. (c) **Customer billing.**—Subject to the right of an end-use customer to choose to receive separate bills from it electric generation supplier, the electric distribution company may be responsible for billing customers for electric services, consistent with the regulations of the commission, regardless of the identity of the provider of those services.

    \* \* \*

    (3) The electric distribution company shall not be required to forward payment to entities providing services to customers, and on whose behalf the electric distribution company is billing those customers, before the electric distribution company has received payment for those services from customers.

    66 Pa. C.S. § 2807(c)(3). [↑](#footnote-ref-60)