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PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

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February 17, 2010

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan

Docket No. M-2009-2123950

Dear Mr. McNulty:

Enclosed for filing, please find an original and nine (9) copies of the **Exceptions** of the Office of Trial Staff (OTS) in the above-captioned proceeding.

As evidenced by the enclosed Certificate of Service, copies are being served on all active parties of record.

Sincerely,

Charles Daniel Shields
Senior Prosecutor
Office of Trial Staff
PA Attorney I.D. #29363

Enclosure
CDS/edc

cc: Parties of record
Chairman Cawley
Vice Chairman Christy
Commissioner Pizzingrilli
Commissioner Gardner
Commissioner Powelson
Chief Counsel Pankiw
Director Davis

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**EXCEPTIONS
OF THE
OFFICE OF TRIAL STAFF**

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Dated: February 17, 2010

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I. INTRODUCTION

The Office of Trial Staff (“OTS”) respectfully submits these instant Exceptions to the January 28, 2010, Initial Decision of Administrative Law Judge Susan D. Colwell (“ALJ Colwell”). This fully litigated proceeding was initiated on August 14, 2009, by the three FirstEnergy jurisdictional electric distribution companies (collectively “FirstEnergy,” “FirstEnergy Companies” or “Companies”) whereby they filed a Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan (“petition” or “filing”). As referenced therein, FirstEnergy’s smart meter technology (“SMT”) filing, with the accompanying proposed Smart Meter Technology Procurement and Installation Plan (“Plan”), was made pursuant to Act 129 of 2008 and the requirements of the Commission’s Implementation Order entered June 24, 2009, at Docket No. M-2008-2092655.¹ As provided for in the Implementation Order, official Comments

¹ Pursuant to Act 129, at 66 Pa. C.S. § 2807(f)(7), the Companies propose to recover all reasonable and prudent costs incurred in the development, provision and management of their submitted Plan on a full and current basis from customers through a reconcilable adjustment clause under Section 1307 of the Public Utility Code, 66 Pa. C.S. § 1307. Petition, p. 10. Further, the Companies seek Commission approval to establish individual tariff riders for each, entitled Smart Meter Technologies Charge Rider (“SMT-C”), to recover the costs incurred during the planning and implementation of the Plan on a current cost basis. Petition, p. 10. FirstEnergy further proposes that the rates resulting from the SMT-C riders be expressed as a monthly customer charge, billed on that basis, and calculated and stated separately for the residential, commercial, and industrial customer classes. Petition, pp. 10-13.

were filed with the Commission Secretary by OTS and a number of other parties on September 25, 2009.

The OTS testimony and exhibits were offered and admitted into the record during the evidentiary hearing held November 19, 2009. Tr. pp. 63-64.² On December 11, 2009, OTS filed its Main Brief setting forth the argument, evidence and law supporting its recommendations to the Pennsylvania Public Utility Commission (“Commission”) that the instant Petition be modified as recommended therein. On December 31, 2009, OTS filed its Reply Brief in this matter.

In the Initial Decision, the ALJ recommends rejection of a number of the OTS recommendations advanced in this proceeding. Rejecting these OTS recommendations was contrary to the public interest. Therefore, these instant OTS Exceptions respectfully urge the Commission not to adopt those particular ALJ recommendations and instead recognize the legitimacy and value of incorporating

2 The OTS testimony and exhibits were provided by OTS Witness Dorothy Morrissey and consisted of six separate documents: the OTS Direct Testimony (OTS Stmt. No. 1) and OTS Exhibit No. 1, the OTS Rebuttal Testimony (OTS Stmt. No. 1-R) and OTS Exhibit No. 1-R, and the OTS Surrebuttal Testimony (OTS Stmt. No. 1-SR) and OTS Exhibit No. 1-SR. We note that page 9 of the Initial Decision provides a listing of the parties’ admitted documents, but omits references to OTS Stmt. No. 1-SR and OTS Exhibit No. 1-SR that were timely distributed and also admitted into the record. Tr. Exhibit Index, pp. 56-57 and Tr. pp. 63-64.

each of the OTS recommendations into the final Order resolving this proceeding.³

As emphasized in the OTS Main Brief, OTS has been actively involved in this

³ As to the specific OTS recommendations, they were summarized in the OTS Direct Testimony, at pages 2 to 3 of OTS Statement No. 1, and are reprinted here as follows [with an identification of the relevant pages in that testimony]:

- Annual Filing and Reconciliation should occur on August 1, with a uniform Commission designated 12 month reconciliation period ending June 30; hearings should occur by October 1; Order should be entered by December 1, and the tariff effective date should be January 1; [pages 6 to 7]
- Quarterly SMT updates should be submitted to the Commission by the Companies including review of its upcoming quarterly projected SMT recoverable costs and rider revenues allowing for rider rate adjustments; [page 9]
- Each Company should use its latest quarterly Financial Report submitted to the Commission to obtain a cost rate of debt. The cost rate of preferred stock should be blended proportionately with the cost rate of debt to determine a composite fixed cost rate which will be applied to the representative capital structure; [page 14]
- Each Company should use the Commission's latest Quarterly Earnings Report of jurisdictional utilities to obtain a cost rate of common equity and a representative capital structure for the electric industry; [pages 15 to 16]
- Over/undercollections computed under the SMT rider reconciliation should be subject to interest using the monthly residential mortgage lending rate published in the PA Bulletin; [pages 20 to 21]
- Interest should be computed similar to the method the Commission currently uses for the DSIC cost recovery mechanism, incorporating a weighted simple annual interest computation method; [page 21]
- Interest should be one directional. Any cumulative net overcollection of interest shall be refunded to the ratepayers. Any cumulative net undercollection of interest is not to be recovered from ratepayers in this, or any future, proceeding; [pages 22 to 23]

proceeding because, inter alia, FirstEnergy's filed Plan to be established for each Company involves significant costs and includes a recovery mechanism designed to recoup those costs from their respective ratepayers.

II. EXCEPTIONS

First, it should be noted that OTS has sought in this and the other EDC's smart meter proceedings to present uniform recommendations to the Commission in an effort to demonstrate the legal, equitable and practical reasons for adopting those recommendations across the board.⁴ With adoption of the OTS-

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- The Companies' SMT Plan administrative start-up costs and their assessment period costs should be capitalized and depreciated over its useful life. [pages 29 to 30]
OTS MB, pp. 5-6; OTS Stmt. No. 1, pp. 2-3.

4 As stated in the OTS Reply Brief:
During this proceeding, OTS analyzed the level of claimed costs, the reconciliation of program costs and ratepayer funds and other issues impacting ratepayers. The results of this analysis was included in the development of the recommendations put forth in the OTS testimony and exhibits entered into the record and as presented in the OTS Main Brief.⁴ We note that OTS has been involved in the Commission smart meter proceedings *for each and every one* of the electric distribution companies ("EDCs") and has presented consistent recommendations, as appropriate for each proceeding, including this filing by FirstEnergy. As maintained in the OTS Main Brief, the Commission should recognize the legal, equitable and practical reasons for adopting the uniformly applied OTS recommendations to resolve the important issues raised in this and the other EDCs' SMT proceedings. During such proceedings, OTS has considered the "big picture" as it relates to the implementation and monitoring of the various SMT plans, and has advanced its recommendations in each accordingly. As such, while the Companies here are certainly entitled to provide their perspectives on each of issues involved, they should not be expected to take into account the broader elements that the Commission can and should consider when approving each of EDC's submitted SMT plans.
OTS RB, pp. 2-3.

recommended practices and procedures applicable to each and every EDC's SMT program, the Commission would be in a position to efficiently conduct an annual review of each EDC's plan implementation and thereby compare and contrast the effectiveness of each program on an "apples to apples" basis. Additionally, OTS has emphasized that the adoption of uniform recommendations would ensure that each EDC would be treated as fairly and equally as possible during such Commission oversight and review.

The instant OTS emphasis upon uniform treatment of the EDCs' plans is particularly relevant at this point in time. We urge a review of the obvious disparity in the respective ALJs' recommendations on similar issues in Initial Decisions recently issued in several other ongoing smart meter proceedings involving jurisdictional EDCs. For instance, the Initial Decision in PPL Electric Utilities Corporation's ("PPL") Petition for Approval of a Smart Meter Technology Procurement and Installation Plan, docketed at M-2009-2123945, issued January 28, 2010, and the Initial Decision in Duquesne Light Company's ("Duquesne") Petition for Approval of Smart Meter Procurement and Installation Plan, docketed at M-2009-2123948 also issued on January 28, 2010 both concern similar issues with dissimilar results.

Unlike the ALJ's recommendation in the Initial Decision here where she recommended that no interest on either over or undercollections should be assessed [FirstEnergy ID, pp. 41-43], the Initial Decision in the Duquesne Light

case appears to recommend Commission adoption of interest at six percent (6%) for both over and under collections. [Duquesne ID, p. 21] Moreover, the Initial Decision in PPL reflects an ALJ-recommended interest of eight percent (8%) for overcollections and six percent (6%) for undercollections [PPL ID, pp. 24-26]. Noting this disparity, OTS submits that such discrepancy is no small matter as the determinations appear to be based upon each ALJ's legal interpretation of the relevant statutory and regulatory authority regarding interest.

Further review of the referenced Initial Decisions will also disclose that disparities exist between and among the Initial Decisions on other such important issues as, *inter alia*, the appropriate annual filing and review schedule for each EDC, the question of whether quarterly updates for the SMT surcharge rate will be made or required, and the method of determining an appropriate cost of common equity to be applied to assets capitalized in the surcharges. Again, this mishmash of treatments on issues common to each EDC's SMT can only serve to complicate Commission review of the ongoing programs, particularly when the different EDC's filings would be made at different times of the year under the different ALJs' recommendations in the various Initial Decisions.

As such, OTS would again urge the Commission to recognize the value of ruling uniformly on each EDC's submitted SMT plan and thus, consider such implications as it reviews the OTS Exceptions presented here regarding the FirstEnergy Companies' submitted SMT plan.

OTS EXCEPTION NO. 1

The ALJ Has Erroneously Rejected The OTS Recommendation That The Commission Establish A Uniform Twelve Month Reconciliation Period Ending On June 30th Of Each Year For The FirstEnergy Companies.

Initial Decision, pp. 10, 38-41.

OTS Main Brief, pp. 10-11.

OTS Reply Brief pp. 7-9.

In the OTS Main and Reply Briefs, OTS recommends that the Commission adopt a uniform designated filing period and review the schedule in this and all other SMT proceedings involving jurisdictional EDCs. OTS MB, pp. 10-11; OTS RB, pp. 7-9. As maintained therein, Commission's adoption of the OTS proposal would provide for administrative and judicial efficiency for the Commission and all involved parties during each annual review process. OTS MB, pp. 10-11; OTS RB, pp. 7-9.

In the Initial Decision here, the ALJ presents the Company's proposed filing and review schedule and then references "OTS witness Morrissey's" proposed schedule without mention of the rationale for the OTS proposed schedule as presented in the OTS testimony and briefs. ID, pp. 41. The Initial Decision's sole reference to the OTS argument is found where the ALJ provides the statement that, "[e]ach EDC is developing and implementing an SMIP that is specific to it, and the timetables of the EDCs do not need to match." ID, p. 41.

Respectfully, the OTS maintains that its recommendation for the establishment of a uniform review schedule for all EDCs has no correlation with

the fact that each EDC is developing their own specific SMIP, nor does the OTS proposal for a uniform EDC filing and Commission review schedule materially affect or compromise an EDC's specific plan. The precise issue at hand relates to the adoption of practices and procedures that would allow for accurate and efficient Commission review of the ongoing implementation of each and every EDC's plan.

As stated in the OTS Main Brief, Commission adoption of these proposed uniform filing dates will serve to avoid conflict with the extensive Commission review process necessary for gas distribution companies' annual 1307(f) proceedings and the scheduled Commission annual review of each EDC's Energy Efficiency and Conservation ("EE&C") Plan. Synchronizing the filing and review dates between those for the smart meter filings and those for such other annual Commission review proceedings to avoid each other during the year will allow the Office of Administrative Law Judge ("OALJ"), the statutory and other interested parties and particularly the Commission sufficient time to review and rule upon all aspects of such filings, and in particular the reported costs to be assessed to ratepayers. OTS MB, p. 11. Further, such considerations are paramount because the Commission assumes the additional responsibilities for the conduct of many more EDC related proceedings on an ongoing annual basis. OTS MB, p. 11.

In concluding the presentation of the OTS argument here seeking Commission adoption of the instant OTS Exception, we would suggest that a

failure to do so (and for that matter, to not adopt the other OTS Exceptions presented) would result in future years characterized by a rolling conglomeration of EDC SMT filings throughout the year - each containing a variety of different computations for such components as interest (or no interest), cost of capital, quarterly adjustments or no quarterly adjustments, and other disparate issues. Such a scenario would likely result in a level of Commission review of each EDC's ongoing plan and implementation that would be less than optimal.

For the foregoing reasons, and those identified in the OTS Main and Reply Briefs, OTS respectfully requests that the Commission adopt the instant OTS Exception and incorporate the result into the final Order resolving this SMT proceeding.

OTS EXCEPTION NO. 2

The ALJ Has Erroneously Rejected The OTS Recommendation That The Commission Require The Companies To File A Quarterly SMT Rate Update Report Showing Projected Revenues And Recoverable Costs For Each Calendar Quarter And Then Adjust The Surcharge Rate As Necessary.

Initial Decision, pp. 40-41.

OTS Main Brief, pp. 12-13.

OTS Reply Brief pp. 9-11.

In the OTS Main and Reply Briefs, OTS first references that the Companies' filed plan does, as would be expected, include a proposal that each of their respective SMT-C riders be reviewed and reconciled on an annual basis. Having noted this basic compliance with Act 129 and the Commission's

Implementation Order, OTS then recommends that the Commission provide for even more frequent scrutiny of the plan by directing the Companies to make quarterly filings to allow their respective SMT-C rates to be reviewed and potentially adjusted quarterly to, among other things, minimize the impact of projection errors. OTS MB, pp. 12-13; OTS RB, pp. 9-11. The OTS Main Brief further maintains that the recommended quarterly filings will serve to more accurately match revenues and costs, as each of the FirstEnergy Companies would be required to review such components on a quarterly rather than simply an annual basis.⁵ OTS MB, p. 12.

The OTS Reply Brief references the Companies' claim that quarterly filings are "neither necessary nor particularly useful," because the Companies do not

5 The OTS recommendation also included the provision that each EDC's quarterly filing be submitted a minimum of ten days before the beginning of each calendar quarter to allow for rate adjustments on the referenced dates of January 1, April 1, July 1 and October 1. Thus, rates would not only be reconciled annually in accordance with the Act and the Implementation Order, but also subject to quarterly review and potential adjustment. OTS MB, pp. 12-13. The mandatory quarterly filings would also have the benefit of providing each EDC with notice of the necessary information and format for such information (and uniform for each EDC) that would be required so that the Commission could conduct a prompt and orderly review of the filing and authorize the surcharge rate change. In contrast, FirstEnergy's proposal for "interim" filings at their discretion as to the timing and nature of the information to be provided may require further scrutiny by the Commission, OTS and other interested parties that would render uncertain the effective date and precise level of the new "interim" rate. Additionally, it is not unreasonable to assume that one or more of the FirstEnergy Companies would make such an "interim" filing at the time of an experienced large over or undercollection and therefore the resultant surcharge rate change, whenever established, would be likely be a greater spike than would occur with regular quarterly adjustments.

anticipate significant variances from quarter to quarter. OTS RB p. 10, citing FirstEnergy MB, p. 33. The OTS Reply Brief further references the Companies' position that the added time, resources and costs the parties and Commission would have to dedicate to reviewing quarterly filings is not worth the benefit of minimizing the impact of potential projection errors or adjusting for unexpected delays and deficiencies. OTS RB p. 10, citing FirstEnergy MB, p. 33.

In the Initial Decision, the ALJ declares the OTS rationale for its recommendation to be "unpersuasive" and cites the Companies' other argument in opposition to quarterly filings - that their proposed SMT-C Riders would already authorize interim adjustments to avoid or preempt material over or under-collection of recoverable costs. ID, pp. 40-41. In rejecting the OTS recommendation and accepting the Companies arguments, the ALJ states in pertinent part that, "there is no reason to require FE ratepayers to foot the bill for quarterly reporting costs ..." ID, p. 41.

In response, OTS contends that a number of reasons exist to determine that *the Companies' arguments* in opposition to quarterly filings and potential adjustments are the arguments that should be deemed unpersuasive. First, it can and should be assumed that each of the FirstEnergy Companies will be routinely tracking their expenditures and reviewing their projections in the normal course of business. As such, having to compile such data to present to the Commission on a quarterly basis should not be a major undertaking. Second, their argument that

their proposed SMT-C Riders are designed to authorize interim adjustments (incidentally, to be determined only by them) to avoid or preempt material over or under-collection of recoverable costs *serves only to undermine their first argument*. Simply put, the Companies' proposal to allow them each to unilaterally determine when such interim adjustments to their respective SMT-C Riders should be made must be based upon the assumption already discussed that they would already be performing the very monitoring functions that they contend would be too time-consuming and unnecessary if quarterly filings were required. Thus, the obvious question arises as to how each of the Companies would know to propose an "interim" adjustment unless they were conducting the type of ongoing review that the OTS recommendation for quarterly filings of such data would require.

Additionally, as pointed out in the OTS Reply Brief, the Companies' arguments regarding the "added time, resources and costs the parties and Commission," will experience are unsupported as the record lacks sufficient quantification of such time and resources costs to determine the accuracy of such a contention. OTS RB, p. 11. The same can be said for the Companies' unsupported contention that they do not anticipate significant variances from quarter to quarter. Again, OTS submits that a review of the instant evidentiary record would find scant support for that proposition. There may be a variety of yet undisclosed or undiscovered reasons why the level of expenditures would vary from quarter to quarter and thus, necessitate a quarterly adjustment to one or more

of the three SMT-C Riders at issue. Only time will tell and only quarterly reporting will demonstrate whether it is or is not the case. From the ratepayers perspective, surely more gradual and more specifically accurate quarterly adjustments to the Companies' rider rates are preferred to one larger annual adjustment.

For the foregoing reasons, and those identified in the OTS Main and Reply Briefs, OTS respectfully requests that the Commission adopt the instant OTS Exception and incorporate the result into the final Order resolving this SMT proceeding. With such adoption, the Commission will have the opportunity to review simultaneous quarterly filings from all the EDCs and will be better situated to compare and contrast the various plans to determine what works and what doesn't and whether each EDC is appropriately administering their respective plan.

OTS EXCEPTION NO. 3

The ALJ Has Erroneously Rejected The OTS Recommendation That The Commission Use A Representative Capital Structure For All EDCs Based Upon A Commission Established Barometer Group Used For The Quarterly Earnings Report.

Initial Decision, pp. 33-36.

OTS Main Brief, pp. 14-15.

OTS Reply Brief pp. 12-15.

In this proceeding, OTS recommends that the Commission use a representative capital structure for FirstEnergy in the recovery of smart meter costs based upon a Commission established barometer group and the resultant capital

structure percentages listed in the Quarterly Earnings Report.⁶ OTS MB, pp. 14-15. OTS RB, p. 12. Further, as stated in the Initial Decision, “OTS believes that a representative capital structure instead of the actual capital structure is important for two reasons: (1) it will be based on the same barometer group that will be used to determine the appropriate cost rate of common equity, and thus match the financial risk associated with the corresponding cost rate of common equity, and (2) since some electric companies have capital structures that are not representative of the industry norm, using a representative capital structure will not advantage or disadvantage any EDC or its ratepayers. OTS MB at 14-15.” ID, p. 33. This characterization is a correct recitation of the OTS position as presented in the OTS Main Brief at pages 14 and 15. However, as noted below, it does not incorporate the arguments in the OTS Reply Brief that respond to the Companies’ contentions.

Having characterized and/or provided excerpts from the respective OTS [Main Brief], OCA and Companies’ position at pages 33-35, the Initial Decision then declares at page 36 that “The weighted cost of capital is meant to be EDC-specific, and therefore, the Companies’ proposal in the SMIP is reasonable, and the OTS proposal is not adopted for the reasons given above.” ID, p. 36.

⁶ As stated in the OTS Main Brief, the overall allowable rate of return is calculated by determining the proportions of capital and cost rates for each type of capital. For such a calculation, it is first necessary to determine the capital structure to be applied, which is the proportion of long term debt, preferred stock and common equity. OTS MB, p. 14.

Presumably, the “reasons given above” relate to the arguments in the provided excerpt from the Companies’ arguments that span pages 34-36 of the Initial Decision. ID, pp. 34-36, citing FirstEnergy MB at 25-27.

However, OTS emphasizes that the Initial Decision fails to either reference or address the arguments presented in the OTS Reply Brief at pages 12 through 15 that serve to refute the Companies’ contentions that are excerpted at length in the Initial Decision. *See*: OTS RB, pp. 12-15. The OTS Reply Brief contains definitive responses to both the Companies’ claim that “the Commission's Implementation Order makes it clear that the return component to be utilized must be based on ‘**the EDC's** weighted cost of capital,’ not some purported industry average” [Bolding in original] *and* the Companies’ argument that, by attributing to each EDC the same generic representative capital structure, the OTS position “... would ensure that some companies under-recover their capital costs while other companies over-recover theirs.” OTS RB, pp. 12-15.

The OTS Reply Brief specifically contends that the Companies’ argument attributes undue importance to the referenced word “the” in the language of the Implementation Order and that it is more reasonable to assume that the Commission in generally discussing cost of capital in its Implementation Order would naturally refer to an EDC in the singular and likely had no intention of limiting the legal interpretation simply by use of that term in the manner argued by the Companies. OTS RB, p. 13. As such, the Commission in its consideration of

this instant OTS Exception should not be so limited simply because the Companies, and apparently the ALJ, seek to construe one word in the language of the Implementation Order in a manner that is unduly literal and narrow. OTS RB, p. 13.

As to the Companies' argument that adopting the OTS recommendation would result in EDCs over or under recovering capital costs, OTS responded by raising the important consideration that some EDCs have capital structures that are not representative of the industry norm and adoption of the OTS recommendation here and in other EDC SMT proceedings presents the Commission with the opportunity to apply a uniform structure that *is* more representative.⁷ OTS MB, p. 15. OTS RB, pp. 13-14.

In further support of the OTS Exception, it is particularly important to again reference the companion OTS recommendation in this proceeding that advocates the use of a uniform cost of common equity for each EDC's SMT recovery of capitalized cost. As such, adoption of this OTS Exception here and in other case

⁷ OTS Ex. No. 1-SR, Schedule No. 1, p. 2, shows that the capital structure for the Pennsylvania jurisdictional EDC's subject to Act 129 have long-term debt ratio ranges from 5.27% to 52.37%. The OTS recommendation to use an industry specific barometer group's capital structure is to develop a representative capital structure that would serve to not only address this excessive disparity but also enable the use of current market data for the derivation of such an equally applied capital structure. OTS RB, p. 14. Given that both the Act and the Implementation Order serve to require and apply uniform standards to each EDC's respective plans and that the OTS recommendation here for the application of a uniform capital structure to be used by all EDCs, it can arguably be seen to be more, rather than less, consistent with that legislative and regulatory approach. OTS RB, p. 14.

will ensure that each EDC will recover *the same overall rate of return* on capitalized assets under their respective surcharges - with no EDC having either an advantage or a disadvantage relative to each other. Finally, OTS reiterates that the mere fact that the nature of the assets to be capitalized might differ from one EDC to the next is insufficient grounds to reject the referenced benefits of applying uniform rate of return recovery treatment for each and every jurisdictional EDC.⁸ OTS RB, p. 14.

For the foregoing reasons, and those identified in the OTS Main and Reply Briefs, we respectfully request that the Commission adopt the instant OTS Exception and incorporate the result into the final Order resolving this SMT proceeding.

OTS EXCEPTION NO. 4

The ALJ Has Erroneously Rejected The OTS Recommendation That There Be A Quarterly Adjustment, Rather Than Simply An Annual Adjustment, Of Each Company's Utilized Actual Cost Rate Of Debt As Published In The Quarterly Financial Reports.

Initial Decision, pp. 34-37.

OTS Main Brief, pp. 15-16.

OTS Reply Brief pp. 15.

As stated in the OTS Reply Brief, “[O]n the subject of the appropriate debt cost rate for the overall rate of return computation, OTS and the Companies agree

⁸ The OTS recommendation also has the advantage of using regularly updated current market data reported in the Quarterly Earnings Report rather than accepting the Companies’ proposal to use more dated base rate case results that may remain unchanged for an indefinite period. OTS RB, pp. 14-15.

that the method of determining the cost rate of debt can be based the data reflected in the quarterly Financial Reports, with OTS recommending quarterly adjustments as necessary and the Companies relying upon only any necessary annual adjustment.” OTS RB, p. 5. The Companies also reference the difference between the two positions in a portion of their argument on the subject, as excerpted in the Initial Decision, where it states: “The Companies state: As noted by Ms. Morrissey in her surrebuttal testimony (OTS Stmt. 1-SR, p. 9), the Companies and the OTS agree that the cost rates of long-term debt and preferred stock should be derived from the Companies’ quarterly earnings reports filed with the Commission. The principal difference between the parties is that the Companies would update and adjust their SMT-Cs annually, while Ms. Morrissey recommends quarterly updating.” ID, p. 36, citing FirstEnergy MB, 27-28.

In a sentence at the top of page 37 of the Initial Decision addressing this issue, the ALJ states, in pertinent part, that “... the Companies’ annual adjustment proposal is approved.”⁹ ID, p. 37. In response, OTS would respectfully suggest that the ALJ failed to give sufficient weight to the OTS argument that using quarterly debt cost rates (rather than simply applying an annual debt cost rate is appropriate here and for all EDCs) because it reflects each Company’s current cost

⁹ For clarification, the ALJ in that sentence also noted that the original OTS recommendation for a blending of debt and preferred stock rates was rejected. The OTS Reply Brief had already acknowledged that the blending issue was no longer applicable to FirstEnergy and was no longer an issue. OTS RB, p. 15.

rate and will best reflect the cost of capital used to finance the smart meter technology. OTS MB, p. 16. OTS reiterates that such quarterly debt costs rates for each EDC will be readily available as they are reported in the Quarterly Earnings Reports. OTS RB, p. 15. This OTS recommendation is consistent and complementary with the OTS recommendations that the Commission use a representative capital structure for FirstEnergy in the recovery of smart meter costs based upon a Commission established barometer group and the resultant capital structure percentages listed in the Quarterly Earnings Report.¹⁰

As such, for the foregoing reasons and those identified in the OTS Main and Reply Briefs, we respectfully request that the Commission adopt the instant OTS Exception and incorporate the result into the final Order resolving this SMT proceeding.

OTS EXCEPTION NO. 5

The ALJ Has Erroneously Rejected The OTS Recommendation That The Cost Rate Of Common Equity For An EDC's Surcharge Be Calculated Using A Barometer Group Derived From The Quarterly Earnings Report.

Initial Decision, pp. 37-38.

OTS Main Brief, pp. 16-17.

OTS Reply Brief pp. 15-18.

On the issue of the appropriate cost rate of common equity for a EDC seeking to capitalize costs in a SMT surcharge in this (and, for that matter, all other) EDC SMT proceedings, OTS recommends the use of a Commission staff

¹⁰ As addressed in the previous OTS Exceptions herein.

calculated cost rate of common equity for the electric industry as presented in the Quarterly Earnings Report.¹¹ OTS MB, p. 16-17. The OTS recommendation provides that this cost rate of common equity would be based upon the Commission determined and published barometer group, which would be used in conjunction with the determination of an appropriate capital structure, while incorporating the quarterly adjusted cost of debt as discussed in OTS Exception No 3 and OTS Exception No. 4 herein.¹² OTS MB, p. 16-17. Further, the OTS Reply Brief emphasizes that, given the fact that the Companies have elected to seek to recover the costs of assets to be capitalized through the quicker and simpler rider mechanism (rather than by the filing of a much more elaborate base rate case for such recovery), the OTS recommendation represents the simpler and more equitable method to determine an equity cost rate to be used by all EDCs and therefore warrants adoption by the Commission. OTS RB, pp. 16-17.

11 The Companies propose to use the cost rate of common equity that was adopted by the Commission in Met-Ed's and Penelec's last distribution base rate cases until updated capital structure and equity cost rate findings are made in a future Met-Ed, Penelec or Penn Power base rate proceeding. FirstEnergy MB, p. 24. The Companies' Main Brief also outlines the OCA proposals whereby OCA generally accepts the Companies' proposals with the qualification that a generic equity cost rate be developed by the FUS in the event the Commission determines that the rate is "no longer representative of current conditions." FirstEnergy MB, p. 24.

12 Again, the aggregate of the OTS recommendations presented in the OTS Main and Reply Brief and as discussed in these Exceptions is that a Commission calculation for both the cost rate of common equity and a representative capital structure based on the Quarterly Earnings Report barometer group is appropriate because it properly matches the financial risk associated with the capital structure to the cost rate of common equity. OTS MB, pp. 16-17.

In further support of Commission adoption of this OTS recommendation, the OTS Main Brief references that a Commission calculated cost rate of common equity is an established Commission procedure that has been used in DSIC proceedings for the water industry where individual equity returns for the water utilities are not used, but rather the Commission calculates a cost rate of common equity that is applied to all companies using a DSIC mechanism.¹³ The OTS recommendation thus relies upon this same precedent and principle to advocate its use for smart meter cost recovery. OTS MB, p. 17.

A review of the section of the Initial Decision addressing the appropriate cost of common equity to use as part of the overall cost of capital component for capitalized assets in each of the Companies' SMC-T riders discloses that none of the above presented OTS argument is referenced; rather the entire discussion consists of two introductory sentences in the body of the decision, a direct, lengthy excerpt from one of the Companies' briefs, and then two concluding sentences that provide:

13 The OTS Reply Brief acknowledged that the Companies had correctly noted in their Main Brief that the Commission's use of a uniform cost rate of common equity in DSIC proceedings occurs when more than two years have passed since the Commission Order in the subject water utility's last base rate case (and we presently note their contention that water company's typically file base rate proceeding more often than EDCs). OTS RB, p. 17. OTS immediately responded by pointing out that the Companies' clarification does nothing to affect the fundamental point being made by the OTS reference, i.e. that there is precedent for Commission use of such a "generic" cost of common equity figure for a utility's surcharge recovery mechanism and that such an approach is eminently appropriate here for the EDCs' recovery of costs incurred for capitalized assets. OTS RB, p. 17.

There appears to be no persuasive precedent for the use of the barometer group, used by FUS in its Quarterly Earnings Reports to calculate the Companies' cost of common equity. Therefore, the reasons enumerated by the Companies, I find that the Companies' proposal is reasonable.

ID, p. 38.

OTS would respond by stating that OTS *has* presented valid reasons, and in our view, compelling reasons for the Commission to adopt the OTS recommendation here. Adoption of the OTS recommendations provide for the use of current market-based equity cost rates, avoids the use of dated return on equity rates, uses cost rates reflective of the electric industry, and would provide equitable and just and reasonable compensation to the FirstEnergy Companies and all other jurisdictional EDCs. OTS RB, p. 18.

For the foregoing reasons and those identified in the OTS Main and Reply Briefs, we respectfully request that the Commission adopt the instant OTS Exception and incorporate the result into the final Order resolving this SMT proceeding.

OTS EXCEPTION NO. 6

The ALJ Has Erroneously Rejected Any Use Of Interest And Thus Has Erroneously Rejected The OTS Recommendations That Interest Be Assessed On Overcollections At The Residential Mortgage Rate.

Initial Decision, pp. 41-43.

OTS Main Brief, pp. 17-20.

OTS Reply Brief, pp. 18-21.

In this proceeding, the Companies proposed that interest be applied to both over and under-collections based on the annual rate identified at 41 P.S. § 202. FE

MB p. 33. In contrast, OTS recommends that interest be one directional, i.e., that interest only be paid to customers on a net overcollections, but not computed for net undercollections, and that it be based on the residential mortgage rate. OTS MB, pp. 18-19; OTS RB, pp. 19-20. As argued by OTS, the Commission currently applies the residential mortgage interest rate in a one directional manner and such precedent is applicable and warranted here. OTS MB p. 19.

In the Initial Decision, the ALJ rejected both proposals and instead concluded that because Section 1307(e) makes no reference to interest, no interest should be applied in this case on either over or under collections.¹⁴ ID, p. 43.

OTS respectfully disagrees with the ALJ and maintains that interest should properly be applied to net overcollections to be refunded to ratepayers. In support of this recommendation, OTS argued and reiterates here that there is a return component in the Companies' surcharge rider for properly capitalized expenditures that provides adequate compensation for their investment. OTS MB p. 19; OTS RB p. 20. As such, the Companies are already compensated for their investment through the rate of return as their proposed smart meter cost recovery mechanism

14 This recommendation was based upon the ALJ's interpretation of Section 1307(e) of the Public Utility Code. In OTS's view, the ALJ has erroneously concluded that since this section makes no mention of interest, it would be inappropriate in this proceeding to infer that interest should be applied. ID p. 43. The ALJ also provides the caveat that should the Commission allow interest by invoking Section 1307(b), that subsection (f)(5) sets forth the mechanism that should be used to determine the proper rate because it has already been determined that it "sets forth a fair, consistent and reliable mechanism for determining the proper rate." ID, p. 43.

will allow for a return of and a return on capitalized assets, the anticipated great bulk of the expenditures. OTS MB p. 19. Further, there exists an important timing consideration regarding the return component of the surcharge mechanism whereby the Companies benefit because the rate base recognition is quicker than it would be if they sought such recognition for a return of and return on their investment through the base rate case process. OTS RB pp. 20-21.

Given this return *of* and a return *on* the asset, OTS maintains that no further monetary adjustment through interest is needed to compensate the EDC for the time value of money between the time of the expenditure and the time the value is reflected in rates. OTS RB pp. 20-21. Because of the aforementioned benefits, it is unnecessary to allow the Companies to recover interest on under collections in addition to the generous (to them) fast-track capitalized recovery through their respective SMT-C surcharge mechanisms.¹⁵

Turning to a separate but related matter, the Initial Decision has also not adopted the OTS recommendation that interest be calculated at the monthly residential mortgage rate. In the OTS Main and Reply Briefs, OTS recommends that interest be applied at the residential mortgage lending rate. OTS MB p. 18; OTS RB p. 18. OTS argued and reiterates here that the residential mortgage rate is

15 And, as explained by OTS Witness Morrissey in her Direct Testimony, the Commission should adopt the interest computation methodology that it currently uses for the DSIC cost recovery mechanism. This methodology incorporates a weighted simple annual interest computation method, rather than compounding interest calculations. OTS Stmt. No. 1, p. 21.

the rate that is currently used by the Commission when calculating the DSIC. Because this is a rate the Commission currently uses in a surcharge mechanism (the DSIC), it follows that the Commission has determined that this is a fair, consistent and reliable method for determining the proper rate of interest. In addition, water companies use a DSIC to recover monies for infrastructure rebuild and improvements, which are capital intensive projects, like the instant smart meter installation. Furthermore, the residential mortgage rate is the appropriate rate to apply because it constitutes the current and best representative cost of borrowed funds. OTS MB p. 18.

For the foregoing reasons, and those identified in the OTS Main and Reply Briefs, we respectfully request that the Commission adopt the instant OTS Exception and incorporate interest at the residential mortgage lending rate only on net over-collections to be refunded to ratepayers. OTS submits this would be the most fair and equitable approach in this scenario where Companies are already receiving a return on the capitalized portion of their investment through their surcharge mechanism.

OTS EXCEPTION NO. 7

The ALJ Has Erroneously Partially Rejected The OTS Recommendation That Both Administrative Start Up Costs And The Monies Expended During The Assessment Period Be Capitalized And Depreciated.

Initial Decision, pp. 44-46.

OTS Main Brief, pp. 20-22.

OTS Reply Brief, pp. 21-23.

In the Initial Decision, the ALJ concludes that the start-up costs incurred during the first 12-month period can be expensed as proposed by the Companies. ID p. 46. The ALJ further states that assessment period cost should be capitalized over the life of the smart meter technology to which the costs are related. ID p. 46. As such, the ALJ has agreed in part and disagreed in part with the OTS recommendation that both start-up and assessment period cost should be capitalized with recovery of carrying costs and depreciation expenses recovered over the term of the Smart Meter Plan. OTS MB, pp. 20-21; OTS RB p. 23.

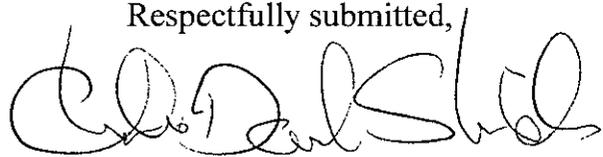
OTS thus excepts to that portion of the Initial Decision that provides for the expensing of the start-up costs, arguing that it is imperative that these expenditures also receive such capitalized treatment because they are investments that provide a benefit over an extended time period just as other similar plant investments would be. An investment in the physical plant would be recovered from those ratepayers who receive the benefit. Therefore, it would be appropriate to depreciate the costs over the life of the asset. Because the number of customers in the service territory remains fluid, it would not be appropriate to recover the costs only from those customers who are in the service territory at the beginning of the recovery period.

For the reasons identified above, and those identified in the OTS Main and Reply Briefs, we respectfully request that the Commission adopt the instant OTS Exception and incorporate the result into the final Order resolving this SMT proceeding.

III. CONCLUSION

For the reasons set forth above and in the OTS Main and Reply Briefs, the Office of Trial Staff hereby respectfully requests that the Commission issue an Order concluding this proceeding that incorporates all OTS positions advanced in this proceeding and as reflected in the OTS Exceptions submitted herein.

Respectfully submitted,



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Dated: February 17, 2010

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Petition of Metropolitan Edison :
Company, Pennsylvania Electric : Docket Nos. M-2009-2123950
Company and Pennsylvania Power :
Company :

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CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Exceptions** dated February 17, 2010, either personally, by first class mail, electronic mail, express mail and/or by fax upon the persons listed below, in accordance with the requirements of § 1.54 (relating to service by a party):

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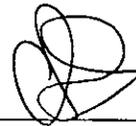
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