



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

IN REPLY PLEASE
REFER TO OUR FILE

November 8, 2010

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: *Pennsylvania Public Utility Commission v.*
Petition of West Penn Power Company d/b/a Allegheny Power for Expedited
Approval of its Smart meter Technology Procurement and Installation Plan

Docket No. M-2009-2123951

Dear Secretary Chiavetta:

Enclosed please find an original and ten (10) copies of the Office of Trial Staff's (OTS) **Exceptions** in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

Richard A. Kanaskie
Senior Prosecutor
Office of Trial Staff
PA Attorney I.D. #80409

Enclosure
RAK/edc

cc: Parties of record
Honorable Mark A. Hoyer
Chairman Cawley
Vice Chairman Christy
Commissioner Coleman
Commissioner Gardner
Commissioner Powelson
Chief Counsel Pankiw
Director Davis

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Petition of West Penn Power Company :
d/b/a Allegheny Power For Expedited :
Approval of its Smart Meter Technology : Docket No. M-2009-2123951
Procurement and Installation Plan :**

**EXCEPTIONS
OF THE
OFFICE OF TRIAL STAFF**

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I. INTRODUCTION

Act 129 of 2008 (“the Act” or “Act 129”), which was signed into law by Governor Rendell on October 15, 2008, imposed new requirements on electric distribution companies (“EDC”). The primary goal of Act 129 is to reduce overall energy consumption and demand. Under the provisions of the Act, every EDC with more than 100,000 customers must achieve a reduction in consumption of one percent (1%) by May 31, 2011. The goal of reduced consumption increases to three percent (3%) by May 31, 2013.¹ In addition to the reduced consumption goals, each affected EDC must reduce annual system peak demand by a minimum of four and one-half percent (4.5%) during the 100 hours of highest demand. The *demand reduction must be achieved by May 31, 2013.*² Act 129 further required EDCs to file Smart Meter Plans within nine (9) months of the effective date of the Act. These Plans must provide smart meter technology to customers that request it, provided they agree to pay the cost of the smart meter at the time of the request, and in new building construction. In addition, the smart meter technology must be offered in accordance with a depreciation schedule not to exceed 15 years.³ The Commission’s Implementation Order established the standards that each Smart Meter Plan must meet and provided guidance on the procedures for submittal, review and approval of each Plan. The Implementation Order mandated that Comments to the Plan be filed by September 25, 2009; Technical Conferences

1 66 Pa. C.S.A. § 2806.1(c).

2 66 Pa. C.S.A. § 2806.1(d).

3 66 Pa. C.S.A. § 2807(f).

be held during October 2009; and Evidentiary Hearings be held during November of 2009.⁴

Pursuant to Section 2807(f) of Act 129⁵ and in accordance with the Implementation Order issued by the Pennsylvania Public Utility Commission (“Commission”) at Docket No. M-2009-2092655⁶, West Penn Power Company d/b/a Allegheny Power (“West Penn” or “Company”) filed a Petition for Expedited Approval of its Smart Meter Technology Procurement and Installation Plan (“Smart Meter Plan” or “Plan”) on August 14, 2009.

West Penn proposes to recover the costs associated with its Smart Meter Plan through a Smart Meter Technology Surcharge (“Smart Meter Surcharge” or “Surcharge”). The Smart Meter Surcharge is proposed as a non-bypassable surcharge under Section 1307 of the Pennsylvania Public Utility Code.⁷ West Penn proposes a fixed rate per month as opposed to basing it on a volumetric rate.⁸ Furthermore, the Surcharge purportedly is designed to recover all the incremental costs to provide, operate and maintain Smart Meter technology on a full and current basis.⁹

The Office of Trial Staff (“OTS”) is charged with representing the public interest in Commission proceedings having an impact on customer rates. The

4 Smart Meter Procurement and Installation Implementation Order, Docket No. M-2009-2092655, p. 6.

5 66 Pa. C.S.A. § 2807(f).

6 Order Adopted June 18, 2009 and Entered June 24, 2009.

7 66 Pa. C.S.A. § 1307.

8 West Penn Petition, p. 97.

9 Id.

OTS representation of the public interest includes balancing the interests of ratepayers, utilities and the welfare of the Commonwealth. OTS initially filed its Notice of Appearance in this proceeding on August 20, 2009 in order to carry out its charge as West Penn's Smart Meter Plan involves significant costs and includes a recovery mechanism that is designed to recoup those costs solely from ratepayers. As such, OTS has examined the Company's original Plan and subsequent amendments with an emphasis on the ratemaking impact of the included programs and the proposed recovery mechanism.

II. HISTORY OF THE PROCEEDING

As indicated above, the Company initially filed its Smart Meter Plan on August 14, 2009. The initial prehearing conference was held on Wednesday, September 30, 2009 at which time a procedural schedule was developed. In addition to a timeline for the submission of testimony, the Procedural Schedule provided for the submission of Main Briefs on December 3, 2009 with Reply Briefs due December 18, 2009. The Procedural Schedule adopted at the Prehearing Conference contemplated the issuance of an Initial Decision on January 29, 2010 in accordance with the Commission's guidelines for Smart Meter Plans. During the Prehearing Conference, Administrative Law Judge ("ALJ") Mark A. Hoyer orally denied West Penn's request to certify a material question to the Commission regarding certification of the record without decision on Smart

Meter Plan Initial Phase Issue.¹⁰ West Penn subsequently filed a Petition for Interlocutory Review and Answer to a Material Question with the Commission's Secretary's Bureau on September 30, 2009. A Technical Conference was held on October 5, 2009 before Administrative Law Judge Kandace F. Melillo. Also on October 5, 2009, a Prehearing Order was issued to confirm the agreements and determinations made at the Prehearing Conference with respect to the future conduct of this proceeding. The unopposed Petitions to Intervene of the Department of Environmental Protection ("DEP"), Constellation, West Penn Power Industrial Intervenors ("WPPII") and the Pennsylvania Association of Community Organizations for Change Now ("ACORN") were granted. The Petition to Intervene filed by Citizen Power was denied. On October 13, 2009, Briefs in Opposition to the Petition for Interlocutory Review and Answer to a Material Question were filed. On October 22, 2009, the Commission denied Allegheny Power's request for an expedited schedule. Furthermore, on November 2, 2009, a Protective Order was issued by Administrative Law Judge Hoyer.

In accordance with the established procedural schedule, OTS served the Direct Testimony of its expert witness on October 16, 2009, its Rebuttal Testimony on October 27, 2009 and its Surrebuttal Testimony on November 3, 2009.

¹⁰ West Penn's request regarding Certification of the Record without an Initial Decision was initially presented in its Prehearing Memorandum.

An evidentiary hearing was held in Hearing Room 2 in the Commonwealth Keystone Building, Harrisburg, Pennsylvania, on November 9, 2009. At the Hearing, the written testimony and exhibits presented by OTS and the active parties were admitted into the record. On November 24, 2009, ALJ Hoyer issued a First Interim Order Modifying the Litigation Schedule and Admitting into Evidence Allegheny Power Exhibit No. 6, Stipulations of Fact (“First Interim Order”). The litigation schedule was subsequently modified by this First Interim Order to require Main Briefs from the interested parties on December 18, 2009 with Reply Briefs due January 5, 2010. Also on November 24, 2009, counsel for West Penn filed a Request for Transcript Corrections. The proposed corrections were granted in accordance with the Commission’s Regulations at 52 Pa. Code § 5.253(f)(2).

On December 17, 2009, West Penn filed a Motion to Reopen the Evidentiary Record. On December 18, 2009, the Company filed a letter seeking to withdraw the Motion to Reopen the Evidentiary Record.¹¹ Also on December 18, 2009, West Penn then filed a Petition to Modify a Prior Commission Order and to Reopen the Evidentiary Record. OCA, OTS, OSBA and ACORN filed answers to the Petition.¹²

11 West Penn requested that the letter it sent for the purpose of withdrawing the Motion to Reopen be accepted in lieu of a formal Petition for Leave to Withdraw under 52 Pa. Code § 5.94. West Penn submitted that pursuant to 52 Pa. Code § 1.2(c) waiver of the Section 5.94 petition requirement is permissible because the waiver will not adversely affect the substantive rights of any party.

12 Section 5.405 of the Commission’s regulations, 52 Pa. Code § 5.405, governs the evidentiary effect of the Petition to Modify a Prior Commission Order and to Reopen the Evidentiary Record and the answers filed in response thereto.

In accordance with the revised litigation schedule set forth in the Interim Order dated November 24, 2009, the Company, OTS, OCA, OSBA, DEP, WPPII, ACORN and Constellation filed Main Briefs on December 18, 2009. On January 5, 2010, West Penn, OTS, OCA, OSBA, WPPII and ACORN filed Reply Briefs. Neither DEP nor Constellation filed a Reply Brief.

On January 13, 2010, West Penn's Petition to Modify a Prior Commission Order and to Reopen the Evidentiary Record was granted by Secretarial Letter. The Commission waived the requirement that an Initial Decision be rendered in this matter on or before January 29, 2010, and remanded the remaining issues in the *Petition for disposition by the presiding Administrative Law Judge.*

A Further Conference was held on January 26, 2010, and a Further Conference Order was issued by ALJ Hoyer that same day. The Further Conference Order established, *inter alia*, a revised litigation schedule for the submission of Supplemental Direct and Rebuttal Testimony and Exhibits; scheduled a Further Evidentiary Hearing for March 16, 2010; and required filing and service of Supplemental Main Briefs on, or before, March 26, 2010.

In accordance with the Further Conference Order, a Further Evidentiary Hearing was held on March 16, 2010. The parties waived the right to cross-examination of the witnesses who prepared supplemental written statements and exhibits, and stipulated to the admission of certain supplemental statements and exhibits offered by the Company, the OCA and the OSBA. Supplemental Main

Briefs were served by Allegheny Power, the OCA, the OSBA and the DEP on March 26, 2010.

As identified in the Initial Decision of ALJ Hoyer, counsel for ACORN filed and served a request to withdraw ACORN's appearance in this proceeding On April 7, 2010. No responses in opposition to this request were submitted by any party.

On May 6, 2010, Administrative Law Judge Mark A. Hoyer issued his Initial Decision in this proceeding. On May 13, 2010, West Penn filed a Petition to Stay the Exceptions Period ("Petition to Stay") purporting that an extension of time would allow the parties to consider the impact of a pending merger between West Penn's parent company and FirstEnergy Corporation on its Smart Meter Plan. On Friday, May 14, 2010, the Secretary of the Commission issued a Letter indicating that the period to submit Answers to the Petition to Stay would be shortened to Tuesday, May 18, 2010. On May 18, 2010, the OSBA filed an Answer opposing the Petition to Stay.

In an Order Adopted on July 15, 2010 and Entered on July 21, 2010, the Commission stated that "[i]f West Penn and the Parties have not filed a proposed Settlement Agreement in this matter...by ninety (90) days from the date of entry of this Opinion and Order, then Exceptions to the Initial Decision will be due one hundred and ten (110) days after the entry date of this Opinion and Order with Reply Exceptions due one hundred and twenty (120) days after the entry date of

this Opinion and Order.”¹³ On October 19, 2010, the Company and the Office of Consumer Advocate submitted a document entitled Joint Petition for Settlement. This document included a request for a shortened response period. On October 21, 2010, by Secretarial Letter, the period to submit an Answer to the Company and OCA agreement was shortened. The Office of Trial Staff submitted its Answer to the Company and OCA agreement on November 1, 2010. OTS maintains that the submitted agreement does not satisfy the Commission’s Order Entered July 21, 2010. As described in the OTS Answer, the Petition is procedurally flawed and substantively flawed. As it represents an agreement only between two (2) parties, it does not satisfy the Commission’s Order. Therefore, in accordance with the Commission’s schedule as articulated in its July 21, 2010 Order, OTS hereby submits its Exceptions to the Initial Decision of Administrative Law Judge Mark A. Hoyer.

III. EXCEPTIONS

OTS has not challenged the programs or proposals that West Penn considers integral to the success of its Smart Meter Plan and supports the recommendations presented by the presiding Administrative Law Judge in his Initial Decision. Rather, OTS maintains that the Company’s proposed Cost Recovery Mechanism requires modification to ensure adequate protection to

¹³ Opinion and Order, Docket No. M-2009-2123951, Order Adopted July 15, 2010 and Entered July 21, 2010, p. 11.

ratepayers while enabling the Company to timely recover all of the appropriate costs associated with the implementation of its Plan.

Exception No. 1:

The Initial Decision's Recommended Capital Structure is in Error.

Initial Decision, pp. 71-73.
OTS Main Brief, pp. 12-13.
OTS Reply Brief, p. 5.

The Initial Decision's capital structure recommendation is inappropriate as it is fundamentally inconsistent with the Rate of Return determination. OTS recommended that the Commission use a representative capital structure for all *EDC smart meter cost recovery based upon the barometer group in the Quarterly Earnings Report*.

The rate of return is calculated by determining the proportions of capital and assigning a cost rate to each type of capital. Therefore, it is first necessary to determine the capital structure, which is the proportion of long term debt, preferred stock and common equity.¹⁴ OTS recommends that the Commission use a representative capital structure for all EDCs in the recovery of smart meter costs that is based upon the barometer group in the Quarterly Earnings Report.¹⁵ As such, the Commission would calculate the appropriate capital structure and publish it in the Quarterly Earnings Report. Until the next Quarterly Earnings Report establishes the capital structure for smart meter cost recovery, OTS

14 OTS St. No. 1, p. 11.

15 OTS St. No. 1, p. 15.

recommends that the capital structure be published in the Order in this proceeding.¹⁶

The representative capital structure is important for two reasons. First, as will be discussed in greater detail below, the representative capital structure is based on the same barometer group that will be used to determine the appropriate cost rate of common equity. As the ALJ has correctly determined that the Commission should determine the appropriate cost rate of common equity, sound financial principles require the application of the appropriate capital structure. Under the OTS recommendation, the representative capital structure will properly match the financial risk associated with the corresponding cost rate of common equity.¹⁷ The ALJ's Initial Decision improperly rejects this principle by creating a mismatch. Using a uniform representative capital structure will not advantage or disadvantage any EDC or its ratepayers. Accordingly, the OTS recommendation provides for a capital structure that is representative of the electric industry and should be approved by the Commission.

A key component in the impact of the proper capital structure is the cost rate of debt and preferred stock. OTS recommends that the Company's actual costs, as found in the most recent quarterly Financial Report,¹⁸ be used in establishing the appropriate costs for this component of the revenue requirement. The cost rate of preferred stock should be blended with the cost rate of debt to

16 OTS St. No. 1-R, pp. 4-5.

17 OTS St. No. 1, p. 15. 5.

18 OTS St. No. 1, p. 16.

determine a composite cost rate for the fixed rate portion of the capital structure.

This recommendation is appropriate because it reflects the Company's current cost rate and will best reflect the cost of capital used to finance the smart meter technology.

Exception No. 2:

The Initial Decision's Interest Recommendation is in Error.

Initial Decision, pp. 24-26.

OTS Main Brief, pp. 15-17.

OTS Reply Brief, pp. 8-9.

West Penn seeks to recover the costs of its Smart Meter Plan through a reconcilable automatic adjustment clause as provided for in Section 1307 of the Public Utility Code. However, the Company's Plan does not include an interest component for over and under-collections in its cost recovery mechanism and the ALJ's Initial Decision fails to implement the appropriate measure. Prudent regulation must include an interest component in this planned mechanism as over and under-collections will, undoubtedly, occur in the course of cost recovery during the pendency of the Company's Plan. OTS maintains that the Company's cost recovery mechanism must provide adequate protection to ratepayers. To accomplish the proper ratepayer protection, the inclusion of the computation of interest to over and under-collections is necessary.

The Company has not proposed to include an interest component in its cost recovery mechanism to be applied to over/under-collections. As argued below, OTS maintains that applying interest at the residential mortgage lending rate is

appropriate. In addition, OTS recommends that the interest component be applied in a manner that ensures that ratepayers are not liable for the payment of any net interest component due to the Company.¹⁹

OTS recommends that interest be computed on any over/under-collection activity for each month in the reconciliation period. OTS proposes that the reconciliation period be the twelve month interval ending June 30.²⁰ Once the proper interest accrued during the reconciliation period is calculated, OTS maintains that only the net interest amount resulting from over-collections (due to ratepayers) be incorporated into the smart meter cost recovery mechanism.²¹ The Smart Meter Plan presented by the Company is capital intensive. Therefore, the recovery of such costs includes a return component.²²

The residential mortgage lending rate contained in Section 1308(d) is the appropriate interest rate to apply in this proceeding because it represents the current cost of borrowed funds.²³ Additionally, the Commission has already recognized the appropriateness of this rate in surcharge mechanisms as it is currently used in DSIC proceedings. Like DSIC projects, smart meter technology involves intensive capital investment by the Company so applying the same interest rate is appropriate.

19 OTS St. No. 1, p. 21.
20 OTS St. No. 1, pp 6, 20.
21 OTS St. No. 1, p. 20.
22 OTS St. No. 1, p. 23.
23 OTS St. No. 1, p. 18.

OTS maintains that the application of interest in Smart Meter Plans should be one directional. This means that net interest due to ratepayers as a result of an over-collection is returned to ratepayers at the rate specified above. However, net interest due to the Company as a result of an under-collection should not be recovered from ratepayers through the smart meter cost recovery mechanism or through any other proceedings. The Company's planned smart meter cost recovery mechanism already allows for the recovery of carrying costs from ratepayers through the return component. The return component appropriately includes the debt cost, the cost of any preferred stock and the cost of common equity.²⁴ As such, West Penn is compensated for its investment through the application of the rate of return. In addition, the one directional application of interest is appropriate because the Commission's current application of the residential mortgage rate on over/under-collections in existing cost recovery mechanisms is already established as one directional.²⁵

²⁴ OTS St. No. 1, p. 21.

²⁵ OTS St. No. 1, p. 21.

IV. CONCLUSION

For the reasons stated herein, the Office of Trial Staff respectfully requests that the Pennsylvania Public Utility Commission modify the Initial Decision of the presiding Administrative Law Judge by granting these Exceptions.

Respectfully submitted,



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Dated: November 8, 2010

BEFORE THE
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Petition of West Penn Power Company :
d/b/a Allegheny Power for Expedited : Docket No. M-2009-2123951
Approval of its Smart meter Technology :
Procurement and Installation Plan :

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Exceptions** dated November 8, 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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