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September 14, 2012

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17101

Re: Pa. Public Utility Commission
v.
PPL Electric Utilities
Docket No. R-2012-2290597

Dear Secretary Chiavetta:

Enclosed please find the Office of Consumer Advocate's Reply Brief in the above-referenced proceeding.

Copies have been served upon all parties of record as shown on the attached Certificate of Service.

Sincerely yours,

Candis A Tunilo

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Enclosures
cc: Honorable Susan D. Colwell
Certificate of Service
155413.DOC

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission,	:	
	:	
v.	:	Docket No. R-2012-2290597
	:	
PPL Electric Utilities Corporation	:	

REPLY BRIEF OF THE OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

On August 29, 2012, PPL Electric Utilities Corporation (PPL or Company), the Office of Consumer Advocate (OCA), the Bureau of Investigation and Enforcement (I&E), the Office of Small Business Advocate (OSBA), Granger Energy of Honey Brook LLC and Granger Energy of Morgantown LLC (Granger), PP&L Industrial Customer Alliance (PPLICA), the Commission on Economic Opportunity (CEO), Direct Energy Services LLC (Direct Energy), Dominion Retail, Inc. (Dominion), and Richards Energy Group, Inc. (Richards) filed Main or Initial Briefs in this proceeding. The Sustainable Energy Fund (SEF) filed a letter in lieu of main brief on August 29, 2012. The OCA will not repeat the arguments expressed in its Main Brief herein but will respond to those matters raised by other parties not previously addressed or which require clarification.

II. REPLY ARGUMENT

A. Rate Base.

1. Plant In Service.

The Company asserted that the OCA's proposed adjustments to Plant in Service to reflect the capitalized portions of OCA witness Koda's recommended adjustments to PPL's payroll expense and incentive compensation expense should be rejected because the Company claimed that the underlying adjustments should be rejected. See PPL M.B. at 19-20. As discussed in OCA's Main Brief at pages 17 through 20 (payroll expense) and pages 20 through 25 (incentive compensation expense) and in this Reply Brief in Section II.C.3. below, OCA's recommended adjustments to payroll expense and incentive compensation expense are reasonable and should be adopted. Therefore, corresponding adjustments to PPL's proposed Plant in Service for the capitalized portions of these expenses is necessary and should be adopted. The capitalized portion of Mr. Koda's recommended adjustment to employee levels resulted in a downward adjustment to PPL's proposed rate base of $1,883,000. OCA Exh. KC-1-SR Sched. 1 at 2; see also OCA M.B. at Table II. The capitalized portion of Mr. Koda's recommended adjustment to PPL's incentive compensation plan results in a downward adjustment to PPL's proposed rate base of $1,678,000. OCA Exh. KC-1-SR Sched. 1 at 2; see also OCA M.B. at Table II.

2. Accumulated Reserve for Depreciation.

In its Main Brief, PPL took issue with the method by which OCA witness Koda calculated the Company's accumulated reserve for depreciation. PPL M.B. at 20-23. As explained in OCA's Main Brief, Mr. Koda annualized the accumulated reserve for depreciation because:

> [t]he reserve for depreciation is built-up by recording depreciation expense related to plant in service, the reserve should reflect the depreciation expense claimed as a reduction of operating income in the rate proceeding consistent with the period ending plant in service claimed in the proceeding.

OCA M.B. at 12; see also OCA St. 1-REV. at 11. As Mr. Koda explained, he utilized this method because:

> 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.

OCA St. 1-SR at 4.

In its Main Brief, PPL supported its opposition of Mr. Koda's adjustment by asserting: (1) that Mr. Koda is not as experienced as PPL's depreciation witness Mr. Spanos and (2) that Mr. Koda's method is unprecedented but Mr. Spanos' method is universally accepted. PPL M.B. at 20-22. The OCA submits that PPL's assertions are without merit. Regarding PPL's first assertion that OCA witness Koda is not as experienced as PPL witness Spanos, Mr. Koda has over 35 years of public utility accounting experience. See OCA St. 1-REV. at 1-3. Prior to beginning his own consulting firm in 1999, Mr. Koda held accounting positions at private consulting firms and at Citizens Utilities Company. Id. Mr. Koda was awarded a MBA degree from the University of Connecticut and a B.S. in Business Administration with a major in accounting from Seton Hall University. Id. Furthermore, Mr. Koda has been testifying before this Commission in electric cases since 1980. See OCA St. 1-REV. at App. A. OCA witness Koda's qualifications and experience show that he is well qualified to testify on accounting issues in this matter. As such, PPL's assertions regarding OCA witness Koda's qualifications and experience must be rejected.

PPL's second assertion that PPL witness Spanos' method has been universally accepted must also be rejected. Mr. Spanos also made this assertion in his rebuttal testimony. See PPL St. 13-R at 4. As in Mr. Spanos' rebuttal, the only specific matter cited by PPL in its Main Brief for the premise that PPL witness Spanos' method is universally accepted was PPL's 2010 base rate case. PPL M.B. at 21. As stated in OCA's Main Brief, however, the revenue requirement portion of PPL's 2010 base rate proceeding was the subject of a black box settlement. OCA M.B. at 13. See also Pa. PUC v. PPL Electric Utilities Corporation, Docket No. R-2010-2161694, Order at 9, 19, 21 (Dec. 21, 2010) (PPL 2010). No specific accommodation was made in PPL 2010 regarding accumulated reserve for depreciation. Id. Additionally, PPL failed to cite any case, in which the method used by Mr. Koda was specifically rejected. As such, PPL's assertions regarding PPL witness Spanos' method being preferable to OCA witness Koda's method are without merit.

The OCA submits that OCA witness Koda's adjustment to accumulated reserve for depreciation is reasonable and appropriate. As explained in OCA's Main Brief, the depreciation expense included in the cost of service and the additions to the depreciation reserve, which are deducted from rate base, should both be based on the level of plant that the Company claims will be in service at the end of the future test year. Mr. Koda's adjustment accomplished this goal and is fair to both the Company and ratepayers. Mr. Koda's proposed adjustment should therefore, be adopted.

Mr. Koda's recommended adjustment results in a reduction to PPL's rate base of $10,417,000 (rounded to the nearest $1,000). OCA St. 1-REV. at 12; Exh. KC-1-REV. Sched. 1 at 2; see also OCA St. 1-SR at 3-5; Exh. KC-1-SR Sched. 1 at 2; OCA M.B. at Table II.

3. Additions to Rate Base.

In its Main Brief, PPL objected to OCA's proposed additions to the Company's rate base but provided no further explanation. See PPL M.B. at 24. As explained in OCA's Main Brief, OCA witness Koda's recommended adjustments to operation and maintenance expenses also had an impact on PPL's accumulated deferred taxes and cash working capital requirements, which is a function of the accounting model used to determine a utility's revenue requirement. See OCA M.B. at 14-15; see also Exh. KC-1-SR Sched. 2 at 6.

PPL stated in its Main Brief 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 M.B. at 23 fn 3. The OCA agrees with this assessment of the issue (see OCA M.B. at 15-16) and submits that its proposed expense adjustments are reasonable, appropriate and in accordance with the Public Utility Code and relevant case law and should therefore, be adopted.

4. Deductions From Rate Base.

In PPL's Main Brief, the Company refers to two of OCA's proposed adjustments that would reduce rate base: (1) deferred income taxes related to OCA's proposed incentive compensation adjustment and (2) deferred income taxes related to deferred storm costs. See PPL M.B. at 30-31. PPL noted that OCA witness Koda withdrew both of the aforementioned proposed adjustments in his surrebuttal testimony but did not remove the adjustment related to incentive compensation in his Exhibit KC-1-SR, Schedule 4, Page 4 (line 20). Id. The OCA submits that OCA witness Koda removed his proposed deferred income tax adjustment related to incentive compensation on Exhibit KC-1-SR, Schedule 1, Page 2 (line 3) and deferred taxes related to deferred storm costs on Exhibit KC-1-SR, Schedule 2, Page 8 (line 4), but agrees that he did not remove the adjustments on Exhibit KC-1-SR, Schedule 1, Page 2 (lines 2 and 12). See OCA St. 1-SR at Exh. KC-1-SR, Sched. 1 at 2. The impact of removing these adjustments as per Mr. Koda's surrebuttal testimony is a net revenue requirement increase of $1,412,000. These adjustments are reflected in Table I REVISED and Table II REVISED, which are attached to this Reply Brief as Appendix A.

In its Main Brief, the OCA noted that in responses to discovery, PPL confirmed an error in the Company's cash working capital data. See OCA M.B. at 16. The Company stated that it would make the adjustment to its final accounting exhibit, and OCA witness Koda therefore, noted the adjustment in his Exhibit KC-1-SR, Schedule 2, Page 4 (line 5). Although the Company recognized the necessary adjustment to correct the data, the Company did not mention the adjustment in its Main Brief. The OCA submits that the adjustment is not disputed and therefore, should be adopted in this matter. As stated in OCA's Main Brief, the updated data resulted in a downward adjustment to PPL's proposed rate base of $1,400,000. OCA Exh. KC-1-SR Sched. 1 at 2 (line 9); see also Table II-REVISED, which is attached hereto as App. A.

B. Revenues.

The OCA has no further comment on this issue.

C. Expenses.

1. Payroll Expense.

In its Main Brief, PPL asserted that it presented "unrebutted record evidence" that the Company requires an employee complement of 2,002 in order to manage and maintain its transmission and distribution systems. PPL M.B. at 71. OCA witness Koda, however, analyzed PPL's employee complement over the past sixteen months and recommended that PPL's employee complement be 1,943 for purposes of calculating payroll and related benefits expenses. See OCA St. 1-REV. at 17-18; OCA St. 1-REV. at Exh. KC-1-REV. Sched 4 at 3. Mr. Koda also presented his analysis of PPL's budgeted employee complement versus its actual employee complement for the first quarter of 2012. Id.

As discussed in OCA's Main Brief, Mr. Koda's analysis showed that PPL's actual number of employees since December 2010 has been much lower than the 2,002 employee complement that PPL claimed in this case. See OCA M.B. at 17-20. Significantly, PPL's actual employee complement for the first three months of the future test year (January, February and March 2012) was far less than budgeted. Id. at 17-18; see also OCA St. 1-REV. at Exh. KC-1-REV. Sched 4 at 3. Specifically, PPL had 60 fewer employees than budgeted in January 2012, 71 fewer than budgeted in February 2012 and 83 fewer than budgeted in March 2012. See OCA St. 1-REV. at Exh. KC-1-REV. Sched 4 at 3. In rebuttal, PPL witness Banzhoff testified that PPL's employee complement was 1,942 as of June 2012. See PPL St. 8-R at 8. This complement, however, is still lower than OCA witness Koda's recommended employee complement of 1,943.

With regard to PPL's assertion that it requires 2,002 employees in order to manage and maintain its transmission and distribution systems, the record evidence does not support this claim. First, there has been no claim made or evidence presented in this proceeding that PPL has been unable to provide adequate management and maintenance of its transmission and distribution systems. Second, as OCA witness Koda's analysis of PPL's employee complement for the past sixteen months shows, PPL has been managing and maintaining its transmission and distribution systems with far less than 2,002 employees since at least December 2010. See OCA St. 1-REV. at Exh. KC-1-REV. Sched. 4 at 3. In fact, PPL has managed and maintained its transmission and distribution systems with a few as 1,917 employees in March 2012. Id.

Although the Company asserted that it plans to hire 106 new employees by December 2012, the Company did not enter any evidence of this plan into the record beyond PPL witness Banzhoff's unsupported assertion. As discussed in OCA's Main Brief, this Commission has stated that budgeted employee levels should be reasonably based on historic data. See OCA M.B. at 18, citing Pa. PUC v. PPL Gas Utilities Corporation, 255 P.U.R. 4th 209, 242 (Pa. PUC 2007) (PPL Gas 2007). The historic data in this matter showed that: (1) PPL's actual employee complement for the first quarter of 2012 was significantly below budgeted amounts and (2) PPL's actual employee complement as of June 2012 was still 60 employees less than the 2,002 employees for which PPL's proposed payroll and related benefits expenses is based.

The OCA submits that it has provided ample evidence to rebut the Company's proposed employee complement in this matter through OCA witness Koda's analysis of the Company's records of budgeted and actual employee complements for the past sixteen months. See OCA St.

1-REV. at 17-18; OCA St. 1-REV. at OCA Exh. KC-1-REV. Sched. 4 at 3; OCA St. 1-SR at 5-6; OCA St. 1-SR at OCA Exh. KC-1-SR Sched. 4 at 3. As such, PPL's proposed employee complement of 2,002 should be rejected, and OCA witness Koda's recommendation that PPL's employee complement be set at 1,943 should be adopted resulting in a downward adjustment to PPL's payroll expense in the amount of $3,740,000. See OCA St. 1-SR at Exh. KC-1-SR Sched. 4 at 3; Sched. 1 at 2. See also Table II-REVISED, which is attached hereto as App. A.

2. Rate Case Expense.

In its Main Brief, PPL asserted that its rate case normalization period of 24 months should be accepted because the Company plans to invest nearly $1.7 billion dollars in capital projects in 2013 and 2014. PPL M.B. at 76. According to PPL, the availability of the Distribution System Improvement Charge (DSIC) in 2013 will "do little to offset the revenue requirement associated with PPL Electric's substantial capital program," and PPL will likely need to file another base rate case in 2014. Id. at 76-77. The OCA submits that the Company's speculation regarding the filing of future base rate cases is not determinative of this issue.

As discussed in detail in OCA's Main Brief, it is well settled that the normalization period for rate case expense is based on a company's historic filing of base rate cases. See OCA M.B. at 25-27, citing Pa. PUC v. Columbia Water Co., 2009 Pa. PUC LEXIS 1423 (2009); Pa. PUC v. City of Lancaster Sewer, 2005 Pa. PUC LEXIS 44 (2005); Popowsky v. Pa. PUC, 674 A.2d 1149, 1154 (Pa. Commw. Ct. 1996); Pa. PUC v. Roaring Creek Water Co., 73 Pa. PUC 373, 400 (1990); Pa. PUC v. National Fuel Gas Dist. Corp., 84 Pa. PUC 134, 175 (1995); Pa. PUC v. West Penn Power Co., 119 P.U.R. 4th 110, 149 (Pa. PUC 1990). PPL's prior three rate cases were filed at the end of March 2004, 2007 and 2010 – exactly three years apart. OCA St. 1-REV. at 21. As such, OCA witness Koda's recommendation to normalize PPL's rate case expense for this proceeding over 3 years should be adopted. This normalization period resulted in a downward expense adjustment of $338,000. See OCA St. 1-SR at Exh. KC-1-SR Sched. 4 at 5.[1]

3. Incentive Compensation.

In its Main Brief, PPL asserted that OCA's recommended adjustment to PPL's and PPL Services' incentive compensation plans and I&E's recommended adjustment to PPL's incentive compensation plan should be rejected because the plans are reasonable, appropriate and a necessary and proper cost of providing service to customers. PPL M.B. at 34. PPL, however, admitted that its and PPL Services' incentive compensation plans benefit shareholders, as well as ratepayers, and the plans are based on the achievement of both operational and financial goals. Id. at 35, 39-40.

PPL listed the specific goals of its and PPL Services' incentive compensation plans on pages 35 through 36 of PPL's Main Brief and confirmed that two of the goals are financially driven. Id. at 35-36. PPL, however, asserted that these financial goals also benefit ratepayers by providing PPL with access to the debt capital market at reasonable rates and providing an internal source of capital that reduces the need to go to the financial markets for additional capital. PPL M.B. at 36. PPL further relied on Butler Township Water Co. v. Pa. PUC, 81 Pa. Commw. 40, 43-44, 473 A.2d 219, 221 (1984), as precedent that utilities are entitled to recover reasonable expenses incurred for the mutual benefit of shareholders and ratepayers. See PPL M.B. at 37-38.

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1 As discussed in OCA's Main Brief, PPL withdrew its claim for amortization of PPL's 2010 rate case expense, which resulted in a downward adjustment of $674,000 to PPL's rate case expense claim. See OCA M.B. at 25. PPL verified the withdrawal of this claim in its Main Brief. See PPL M.B. at 75. As shown on Table II attached to the OCA's Main Brief, this adjustment and the normalization period adjustment discussed above result in a total downward expense adjustment of $1,012,000. See also OCA St. 1-SR at Exh. KC-1-SR Sched. 1 at 2 (line 21).

In Butler Township, the Commission disallowed one-half of the company's claimed rate case expense under a policy determination that rate case expense should be shared between shareholders and ratepayers. 81 Pa. Commw. at 43-44, 473 A.2d at 221. The Commonwealth Court found that this was improper and held that in the absence of a showing that the claimed rate case expense was unreasonable, imprudently incurred or excessive, the company was entitled to recover the entire claimed amount. Id. The holding in Butler Township is not applicable here, where PPL's and PPL Services' incentive compensation expenses are at issue, and OCA and I&E have put forth evidence that charging 100% of these expenses to ratepayers is unreasonable given that the goals of the plans benefit both shareholders and ratepayers. Furthermore, as set forth below, this Commission has recognized that the Commonwealth Court's holding regarding rate case expense in Butler Township is not determinative with respect to bonus compensation expenses. See PPL Gas 2007, 255 P.U.R. 4th at 233. PPL also cites T.W. Phillips Gas and Oil Co. v. Pa. PUC, 474 A.2d 355 (1984) as a case with a similar holding as in Butler Township. PPL M.B. at 38. T.W. Phillips was litigated and decided during the same time period as Butler Township, and the Commonwealth Court struck down similar treatment of T.W. Phillips' rate case expense in accord with its holding in Butler Township. 474 A.2d at 366-67. The OCA submits that T.W. Phillips is not controlling here for the same reasons as Butler Township.

PPL relied on the following additional cases in support of its assertion that it should recover all of its proposed incentive compensation expense and its portion of PPL Services' incentive compensation expense from ratepayers: PPL Gas 2007; Pa. PUC v. Aqua Pennsylvania, Inc., 2008 Pa. PUC LEXIS 50 (2008) (Aqua 2008); Pa. PUC v. Duquesne Light Co., 63 Pa. PUC 337 (1987) (DLC 1987); and Pa. PUC v. Philadelphia Gas Works, 2008 Pa.

PUC LEXIS 32 (2008) (PGW 2008). See PPL M.B. at 36-37. These cases are all distinguishable from the facts of this matter.

With regard to PPL Gas 2007, as already stated above, it was in this case that the Commission determined that the Commonwealth Court's holding in Butler Township was not binding on it for purposes of bonus compensation expense. See PPL Gas 2007, 255 P.U.R. 4th at 233. At issue in PPL Gas 2007 was the company's variable pay expense claim that comprised 10% of non-union employees' salaries, which was at risk based on the achievement of certain financial, operational and safety-related objectives. Id. at 230. In permitting the expense, the Commission accepted the company's argument that the variable pay program was intended to be combined with employees' base salaries to provide market rate compensation, and shareholders contributed to the expense when payments exceeded budgeted amounts. Id. at 231, 232-33. In the present matter, there is no evidence that any portion of PPL's or PPL Services' employees' base salaries are put at risk in the incentive compensation programs. Further, PPL's shareholders do not currently contribute to the payment of incentive compensation to PPL's or PPL Services' employees. Importantly, however, the Commission explicitly stated in PPL Gas 2007 that: "we do not agree with the Company that the adjustment urged by the OTS would be prohibited as a matter of law under Butler." PPL Gas 2007, 255 P.U.R. 4th at 233.

In Aqua 2008, the Commission approved the company's incentive compensation expense because the program was focused on improving operational effectiveness, including customer service. Aqua 2008, 2008 Pa. PUC LEXIS at *24. In the present matter, a focus of PPL's and PPL Services' incentive compensation programs is profitability. See OCA M.B. at 21-23; PPL M.B. at 35-36. Further, PPL's parent company relies on this profitability for its own financial success. See I&E Cross Exh. 5 at 1.

Both DLC 1987 and PGW 2008 involved unique fact patterns that do not control the outcome of the present matter. In DLC 1987, the company's executives had received a 5% to 10% pay reduction at the time the incentive compensation program was introduced, and this payroll expense reduction was reflected in the company's base rate filing. DLC 1987, 63 Pa. PUC at 374. PGW 2008 involved the company's request for expedited extraordinary rate relief, and the Commission directed the company to implement an incentive compensation program for management employees with the focus of the program being reduced expenses and increased revenues. PGW 2008, 2008 Pa. PUC LEXIS at *60. The present matter does not involve a unique fact pattern regarding incentive compensation expenses. Instead, the facts in the present matter are similar to the facts in the cases discussed in OCA's Main Brief, wherein the Commission directed that the expense be shared by ratepayers and shareholders. See OCA M.B. at 21-23, citing Pa. PUC v. UGI Utilities, Inc.-Electric Division, 82 Pa. PUC 488, 508 (1994); Pa. PUC v. Roaring Creek Water Co., 81 Pa. PUC 285 (1994); Pa. PUC v. Philadelphia Gas Works, 2007 Pa. PUC LEXIS 45 (2007).

As discussed in OCA's Main Brief, it is well settled in this Commission's prior decisions that incentive compensation expense will be shared by ratepayers and shareholders when it is shown that a focus of the incentive compensation plan is the company's profitability. See OCA M.B. at 21-23, citing Pa. PUC v. UGI Utilities, Inc.-Electric Division, 82 Pa. PUC 488, 508 (1994); Pa. PUC v. Roaring Creek Water Co., 81 Pa. PUC 285 (1994); Pa. PUC v. Philadelphia Gas Works, 2007 Pa. PUC LEXIS 45 (2007). In this proceeding, PPL has confirmed that its and PPL Services' incentive compensation plans are designed to benefit both ratepayers and shareholders. See e.g. PPL M.B. at 35, 39-40. Further, during hearings in this matter, it was shown that 70% of the ongoing earnings of PPL's parent company, PPL Corporation, "will come from our rate-regulated businesses in the United Kingdom, Kentucky and Pennsylvania," which confirmed that PPL's parent company relies heavily on PPL's profitability to meet the earnings goals of the parent company. See I&E Cross Exh. 5 at 1.

Additionally, the amounts involved in this matter are significantly more than the amounts at issue in PPL Gas 2007 and Aqua 2008, the two most recent cases cited by PPL in its Main Brief. The total incentive compensation expense sought by the company in PPL Gas 2007 was \$279,085. PPL Gas 2007, 255 P.U.R. 4th at 230. The total incentive compensation expense sought by the company in Aqua 2008 was \$3,892,985. Aqua 2008, 2008 Pa. PUC LEXIS at *20. In this matter, PPL has claimed total incentive compensation expenses of \$18,740,000 (\$8,937,000 for PPL and \$9,803,000 for PPL Services). See OCA St. 1-SR at Exh. KC-1-SR Sched. 4 at 4. This is a significant amount of expenses that the Company has proposed to recover from ratepayers for programs that focus on the profitability of the Company for its parent, PPL Corporation.

Under the facts of this case, the OCA submits that OCA witness Koda's recommendation that PPL's ratepayers and shareholders should share equally in the cost of PPL's and PPL Services' incentive compensation plans expense is reasonable and appropriate and should therefore, be adopted. Mr. Koda's recommendation resulted in a downward adjustment to PPL's proposed expenses of \$4,468,000 related to PPL's incentive compensation plan and \$4,902,000 related to PPL Services' incentive compensation plan. See OCA Exh. KC-1-SR, Sched. 4 at 4; Sched. 1 at 2 (lines 19 and 20); see also Table II-REVISED, attached hereto as App. A.

4. Consumer Education.

In its Main Brief, PPL opposed OCA's recommended adjustment to its proposed consumer education expense. PPL M.B. at 84. According to OCA witness Koda's understanding, PPL intended to recover the following costs through its consumer education rider:[2] $5,482,220 annually for ongoing consumer education programs, $400,000 for annual Retail Market Investigation (RMI)[3] postcards, and $400,000 for the RMI postcard sent to customers in 2012 amortized over two years (or $200,000 per year for two years). PPL St. 5-R at 29. Additionally, other costs proposed to be collected through the CER were of unspecified, non-estimated amounts. Id.

OCA witness Koda recommended that PPL's allowable consumer education expense be $5,400,000 annually, which is close to PPL's 2012 consumer education expense amount of $5,482,220. See OCA St. 1-SR at 8-9. Mr. Koda's adjustment incorporated OCA witness Colton's recommendations regarding form, content and audience of PPL's consumer education programs, which are discussed in OCA's Main Brief at pages 121 through 124 and below in Section II.G.3. OCA St. 1-REV. at 24. As explained in OCA's Main Brief, PPL agreed to implement OCA witness Colton's recommendations regarding its consumer education programs. OCA M.B. at 123-24.

With regard to additional expenses related to the RMI postcards, PPL proposed a substantial increase in its annual consumer education expense to recover these costs. The OCA submits, however, that PPL should utilize its ongoing consumer education expense level, recommended to be set at $5,400,000, to cover these expenses before seeking additional funds. In a similar case, PECO Energy Company sought recovery of an additional $1.4 million through its consumer education surcharge to recover the costs of the RMI mailings. See Petition of

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2 PPL named this rider the Competitive Enhancement Rider (CER). Other aspects of the CER, including the structure of the rider and other costs proposed to be recovered through the rider, are discussed below in Section II.G.4 .

3 See Investigation of Pennsylvania's Retail Electricity Market: Intermediate Work Plan, Docket No. I-2011-2237952 (RMI).

PECO Energy Company for Expedited Approval of its 2012 Consumer Education Plan, Docket No. P-2011-2279773, Order at 2-4 (Jan. 27, 2012). PECO, however, stated that to the extent any funds remained in its consumer education plan, PECO would first use any such remaining funds to offset the cost of the mailings. Id. at 4. The Commission approved PECO's request with the caveat "that PECO will use any remaining funds in the Company's Consumer Education Plan for 2008-2012 before using future surcharge collections." Id. at 5. The OCA submits that the Commission should likewise require PPL to utilize existing funds in its ongoing consumer education plan to cover the costs of RMI mailings before seeking an increase in funding.

The OCA submits that Mr. Koda's recommended adjustment is reasonable and appropriate and therefore, PPL's annual consumer education expense should be set at $5,400,000. See OCA St. 1-SR at Exh. KC-1-SR, Sched. 1 at 2.

D. Taxes.

As discussed in OCA's Main Brief, the OCA has not recommended any adjustments to taxes in this proceeding, with the exception of payroll taxes as they relate to individual expense adjustments. See OCA M.B. at 29. Such adjustments are discussed within their corresponding expense sections in OCA's Main Brief. Although not specifically addressed by PPL in its Main Brief, the OCA submits that any adjustment to PPL's proposed expenses must have a corresponding adjustment to taxes. See also Sections II.A.1 and II.A.3 above.

Also in its Main Brief, the OCA recommended adjustments to PPL's proposed Federal and State taxes applicable to interest synchronization and to PPL's proposed Capital Stock Tax. Id. PPL did not address the proposed adjustment to PPL's proposed Federal and State taxes applicable to interest synchronization and PPL's proposed Capital Stock Tax in its Main Brief. These adjustments should be adopted.

OCA's proposed downward adjustment to interest synchronization is in the amount of $18,469,000. See OCA Exh. KC-1-SR Sched. 4 at 7. OCA's proposed adjustment for Capital Stock Tax was an upward adjustment to PPL's proposed revenue requirement in the amount of $107,000. See OCA Exh. KC-1-SR Sched. 4 at 8; Sched. 1 at 2 (line 25). See also Table II-REVISED, which is attached hereto as App. A.

E. Cost Of Capital.

1. Introduction.

The OCA responds in this part of its Reply Brief to arguments made by PPL in its main brief as to the cost of capital issues. The OCA relies on the complete discussion of these issues as provided in its Main Brief, and will not seek to reargue each and every point made there in this Reply Brief. Rather, the OCA will focus its comments on those areas where the Company directly addresses the OCA's cost of capital arguments. That said, however, PPL makes two rather sweeping statements that the OCA will comment on here.

First, PPL opines that this rate case has implications for all Pennsylvania utilities and their customers, as the first litigated case for a major utility following the Great Recession. PPL M.B. at 87. Second, PPL alleges that, in spite of this backdrop, OCA (and I&E) have chosen "to look backward rather than forward." Id. Both of these statements are apparently meant to highlight the Company's disagreements with the ROE recommendations of both I&E and OCA.

In response, the OCA submits that the Commission should view the record as a whole, based on the known facts, in arriving at its decision. To that end, some review of past history is appropriate, as OCA witness Hill testified:

> my recommended 9.00% return on equity, operating through OCA's recommended ratemaking capital structure indicates an overall return of 7.19%. That overall return affords the Company an opportunity to achieve a pre-tax interest coverage level of 3.46 times. That level of pre-tax coverage is above the

> level of interest coverage actually achieved by PPL over the past five years, which has averaged 3.04. It is also important to note that during that time period when actual interest coverages were substantially lower than that which can result from my overall return recommendation, PPL was able to maintain its investment-grade credit position. Therefore, the equity return I recommend is not inadequate, as Mr. Moul claims. Rather, it directly adheres to the requirements of Hope and Bluefield of providing the Company an opportunity under efficient management to earn a return that supports and maintains its ability to attract capital.

OCA St. 2-SR at 15 (emphasis added). Contrary to PPL's assertions that OCA is only interested in a "rear-view mirror" review, the OCA agrees that "the Commission's findings must be based upon substantial and competent evidence on the record before it, not upon speculation or hypothesis." Ohio Bell Telephone Co. v. Pub. Util. Comm. of Ohio, 301 U.S. 292 (1937); United States Steel Corp. v. Pa. PUC, 390 A.2d 849 (Pa. Commw. Ct. 1978); Octoraro Water Co. v. Pa. PUC, 391 A.2d 1129 (Pa. Commw. Ct. 1978). The OCA has provided this level of substantial and competent evidence, on the current record before the Commission.

As to PPL's invitation to look to the future, the Company has provided that it plans to file for a Distribution System Improvement Charge (DSIC). Tr. at 294. If PPL wishes the Commission to peer into the future in arriving at a reasonable cost of capital for the Company, then the OCA submits that a DSIC will reduce PPL's risk profile and should weigh in favor of a lower ROE in this case.

As to major rate cases being decided since the Great Recession, as PPL stated, the OCA submits that relevant examples exist and that this Commission need not approach this case as new and unexplored territory. For example, the Public Service Commission of Maryland provided the following in approving a 9.31% return on equity in its July, 2012 Order, as to the rate increase request of the Potomac Electric Power Company PEPCO):

> 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 at 109 (MD PSC, July 20, 2012). This decision was rendered just two months ago, and undoubtedly involves a major electric utility.

As to PPL's specific arguments against the OCA's cost of capital positions, the OCA specifically discusses in the following sections its reasonable recommendations as to a capital structure for ratemaking purposes and as to an appropriate cost of common equity for PPL, considering the record as a whole.

In support of its Cost of Capital positions, the OCA now submits this Reply Brief.

2. Capital Structure.

OCA witness Steve Hill's proposed capital structure of 47.16% equity/52.84% debt is reasonable, consistent with how PPL has been capitalized over the last few years prior to its current rate case filing, and similar to the manner in which the electric utility industry is capitalized. The Company's proposed capital structure[4] is unnecessarily burdensome to ratepayers, contains more common equity capital than the electric industry on average, and is inconsistent with how PPL has been capitalized over the last several years prior to this rate case being filed. The OCA is opposed to the use of PPL's proposed capital structure for setting rates in this matter. The OCA submits that the Commission should protect consumers against excessive costs and set rates based on the capital structure as recommended by OCA witness Hill.

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4 As filed, the Company's proposed capital structure was 51.03% equity/48.97% debt. After the close of the record, PPL issued $250 million of new debt at a 2.61% interest rate. This large debt issuance, coupled with the interest rate for this new debt that is almost 300 basis points lower than PPL's average, embedded long-term debt cost (5.56%) results in a proposed capital structure of 50.78% equity/49.22% debt. PPL M.B. at 91, fn 16.

In its main brief, the Company argues that the OCA's proposed capital structure is hypothetical, and thus cannot be accepted. PPL M.B. at 100-102. The OCA submits that PPL is incorrect on this point, for several reasons, as the OCA will address next.[5]

As to the issue of a "hypothetical" capital structure, Mr. Hill explained that:

> As shown on page 4 of Schedule 1 attached to my Direct Testimony, I have constructed a recommended ratemaking capital structure in *exactly the same manner* as PPL. In fact, as noted on that page, the source of the information for my capital structure recommendation is Mr. Moul's own Schedule 6.
>
> My capital structure recommendation begins with the Company's actual year-end 2011 capital structure (just as the Company's recommendation does), assumes all the projected capital changes through year-end 2012 (additional paid in capital, retained earnings, total long term debt and preferred stock). The *only* difference between my projected year-end 2012 forward rate year capital structure and that requested by the company is that I assume PPL parent company management elects to classify the $150 Million capital contribution to PPL Electric Utilities as debt rather than equity. This is a simple task for the parent.
>
> Therefore, if my capital structure recommendation in this proceeding is "hypothetical" as Mr. Moul claims, then so, too, is that of PPL, because they are based on the very same projected data. As I noted above, I have merely made a different projection as to how PPL parent company management should treat its $150 million capital contribution to PPL. I project that the year-end 2012 capital structure will provide a better balance between ratepayers and investors than that assumed by the Company.

PPL St. 2-SR at 12 (emphasis in original). As Mr. Hill explained, PPL's focus on actual versus hypothetical capital structures in this proceeding is misplaced.

Mr. Hill went on to testify as to why the OCA's recommended capital structure is appropriate for PPL, as PPL is a subsidiary of a public utility holding company. Mr. Hill testified in relevant part, as follows:

> Capital structure, especially the capital structure of the utility subsidiary of a parent holding company, is the direct result of decisions made by company management. As such, capital structure is no different from management decisions regarding staffing levels, tree-trimming costs, or other operating costs. Management makes choices regarding the level of costs it will incur and the

[5] See also OCA M.B. at 38-46 for a complete discussion as to OCA's capital structure proposal.

regulatory body reviews those management choices to determine if they are reasonable.

. . .

The Company plans to shift its capital structure to one that contains more common equity than it has used in the past and more common equity than is used in the electric utility industry, on average. As shown on Mr. Moul's Schedule 6 attached to his Direct Testimony, the Company plans to reduce its reliance on preferred stock and increase its reliance on more expensive common equity, by means of a $150 million capital contribution to PPL Electric by its parent company. Again, this is simply a management decision at PPL Corp., to attempt to change the regulated capital structure of PPL Electric.

. . .

The Company asks this Commission to adopt its expensive capital structure simply because it was used to project a rate-year capitalization, without any review of the reasonableness of its increased cost to customers. I do not believe this Commission would treat other management decisions that caused substantial cost increases in that manner, and I do not believe this Commission should treat PPL's capital structure decision that way either. The Company maintained its "BBB" corporate credit rating (and an "A-" secured debt rating) during the time it was capitalized more cost effectively, i.e., with a much lower common equity ratio.

OCA St. 2-SR at 11-12. As Mr. Hill explained, it is reasonable and appropriate to adopt the OCA's recommended capital structure in this proceeding as PPL is a subsidiary of a public utility holding company and, as such, is not publicly traded. Contrary to PPL's allegations, adoption of the OCA's recommended capital structure is also completely consistent with the law.[6]

PPL next argues that its proposed capital structure in this proceeding is actually consistent with how the Company has been capitalized over the last several years, if its proposed capital structure is viewed through the lens of the rating agencies. PPL M.B. at 101. The OCA has submitted substantial evidence, however, to show that PPL's proposed capital structure in

[6] Pennsylvania courts have upheld the Commission's authority to revise a utility's claimed capital structure where the utility's management adopts an actual capital structure that imposes an unfair cost burden on ratepayers. See T.W. Phillips Gas and Oil Co. v. Pa. PUC, 81 Pa. Commw. 205, 217, 474 A.2d 355, 362 (1984); Carnegie Natural Gas Co. v. Pa. PUC, 61 Pa. Commw. 436, 433 A.2d 938 (1981). See also OCA M.B. at 45-46.

this case contains significantly more equity than the manner in which the Company has been capitalized for the last four-five years.[7]

As Mr. Hill testified, PPL has proposed a capital structure in this proceeding that contains significantly higher equity ratios than the Company has used in the near recent past ,specifically that:

> According to data from the Company's Filing Exhibit B-8 (Historical), the ratemaking capital structure contains considerably more common equity than the capital structure appearing on the Company's books, on average, since 2007. As shown on page 1 of Schedule 1 attached to this testimony, the capital structure that appears on the balance sheet of PPL Electric Utilities from 2007 through 2011 consisted of 44.00% common equity, 9.09% preferred stock and 46.91% long-term debt, on average. Also, Mr. Moul's Exhibit PRM 1, Schedule 2 shows the Company's average common equity ratio from 2006 through 2010 to be 43.7% of permanent capital. Therefore, the Company's requested ratemaking capital structure contains considerably more common equity than the manner with which it has been successfully capitalized historically.

OCA St. 2 at 19-20; see also OCA M.B. at 39-42. As the record indicates, PPL is incorrect, as to any measure of its proposed capital structure; the Company's proposed capital structure here is too heavily laden with equity and must be rejected.

As a corollary to this historic equity argument, PPL also alleges that the OCA has failed to show that the Company's proposed capital structure is inconsistent with comparable electric companies. PPL M.B. at 102. Here again, the evidence of record is clear that PPL's allegations are without merit. As Mr. Hill testified, PPL's proposed capital structure contains significantly more equity than comparable utilities. As Mr. Hill discussed:

> Page 3 of Schedule 1 shows the common equity averages for the electric utility and combination gas and electric utility industry, as reported by AUS Utility Reports in its May 2012 publication. That average common equity ratio for publicly-traded electric and combination gas and electric utilities is 45.9% of total capital.

. . .

7 PPL does not contest the fact that the OCA has shown the average common equity ratio for 2007-2010 is 48.54%. PPL M.B. at 101, fn 20.

> Also, the data shown on Mr. Moul's Schedules 3, 4 and 5 show that the average common equity ratio of his integrated electric sample group, and the S&P Public Utilities was 44.4%, and 45% in 2010, respectively. Those average common equity ratios are far below the 51.01% common equity ratio requested for PPL—a lower-risk electric delivery company. Those data indicate that the Company's actual historical common equity ratio (approximately 44%) was in line with that of the publicly-traded electric utility industry.

OCA St. 2 at 22-23. Further, as Mr. Hill succinctly stated during the hearings:

> The average equity ratio for a fully integrated electric company is about 46 percent in this country, 46 percent. The company is asking for a 51 percent equity ratio. This is a less risky company asking for more equity capital. I don't think that's fair for ratepayers.

Tr. at 326.

The evidence of record in this case supports adoption of the capital structure that Mr. Hill recommends. The proposed capital structure of PPL is the result of unilateral decisions by PPL Corporation and is atypical for comparable electric utilities. The Commission has an obligation to consider the interests of ratepayers in the rate of return determination and to protect against excessive costs. The Commission should adopt the capital structure recommended by Mr. Hill as supported by both the law and the record in this case.

3. Cost Of Common Equity.

The Company's request for an 11.25 % return on common equity is excessive, would result in a shareholder windfall at the expense of ratepayers and would result in rates that are unjust and unreasonable. As the record indicates, the current and near-term future economic outlook is one that reflects a historically low cost of capital. The Commission should consider the reasonable range of the cost of common equity proposals submitted in this proceeding, based primarily on the DCF methodology, and adopt the OCA's recommended ROE of 9.0%.[8] In

[8] See OCA M.B. at 47-64. Note that the OCA's recommended ROE of 9.0% is premised on the Commission accepting the OCA's recommended capital structure. Should the Commission decide to accept PPL's proposed

addition, based on the record evidence in this matter, PPL's request for a 12-basis-point ROE adder for management performance should be rejected.

a. PPL's Criticisms Of Mr. Hill's DCF Method Are Without Merit And Should Be Rejected.

In its main brief, PPL argues that the OCA's recommended ROE of 9.0% is unsupported by the DCF method for three reasons: (1) Mr. Hill's growth rate is understated; (2) no "leverage adjustment" is included; and, (3) the lower end of the DCF range is selected. PPL M.B. at 125-129. The OCA addresses each of these arguments in the following section. The OCA notes here, however, that the differing ROE recommendations between Mr. Hill and Mr. Moul are not based primarily on the DCF analyses in this matter, as Mr. Hill testified:

> Mr. Moul's DCF result for his sample companies averages 9.68% without "financial risk adders." When combined with an overstatement in the expected growth rate of at least 30 to 50 basis points as well as an overstatement in dividend yield of another 8 basis points, Mr. Moul's DCF results in this proceeding tend to support the reasonableness of the 8.75% to 9.5% range of equity cost estimates I recommend.

OCA St. 2 at 71. As Mr. Hill testified, and even without consideration of Mr. Moul's overstatement of certain DCF components, Mr. Moul's DCF results are very similar in value to those of Mr. Hill.

PPL alleges that Mr. Hill has not given sufficient weight to analysts' forecasts of earnings growth rates. PPL M.B. at 126. In his Direct Testimony, Mr. Hill preliminarily explained why this statement is false, 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 [analyst] 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

capital structure with a significantly higher equity component, then the OCA recommends an ROE of 8.75%. See OCA St. 2 at 53.

> 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. As Mr. Hill testified, his DCF growth rate is well above the analysts' projected growth rates, and his growth rate estimate gives due consideration to several other leading indicators of growth rates. In addition, in his Surrebuttal Testimony, Mr. Hill directly responded to PPL criticisms of his growth rate, in relevant part as follows:

> The use of actual data [unadjusted] published by Value Line is a reasonable procedure through which a long-term sustainable growth rate may be estimated.
>
> Second, in crafting an "adjustment" to my DCF results to account for my reliance on published Value Line data rather than the adjusted data he recommends, Mr. Moul calculates a 31 basis point impact that would be generated using his adjusted Value Line data and adds that amount to my DCF result. Mr. Moul's analysis assumes that my DCF growth rate is based solely and entirely on a sustainable ("b x r") growth rate analysis, however, that is not true. As I note at page 28 of my Direct, I rely on projected and historical growth in earnings, dividends and book value as well as historical and projected sustainable growth in determining a DCF growth rate.
>
> Schedule 3 attached to my Direct Testimony shows that the average "b x r" or sustainable growth rate projected by Value Line for my sample group for the 2015-2017 period is 3.84%. If we add Mr. Moul's 31 basis point "adjustment" to that figure, the result would be a DCF growth rate of 4.15%. However, my DCF growth rate, based on *all* of the growth rate data I reviewed, shown on Schedule 4, page 2, is 4.94%. Therefore, Mr. Moul's adjustment is without merit because the DCF growth rate I used is substantially higher (certainly more than 31 basis points higher) than the sustainable growth rate that Mr. Moul incorrectly assumed was the sole source of my DCF growth rate estimate.

OCA St. 2-SR at 18. As the record shows, Mr. Hill has given ample weight to analysts' forecasts in arriving at his recommended DCF growth rate estimate. Contrary to Mr. Moul, however, Mr.

Hill has not exclusively relied on analysts' forecasts, consistent with industry publications, as Mr. Hill explained:

> I have previously addressed the problems with relying heavily on projected earnings growth rates at pages 33 through 37 of my Direct Testimony and will not repeat that discussion here. The concerns I cite in my Direct Testimony are also echoed in an investor guide published by the Financial Industry Regulatory Authority (FINRA), which I have attached as Surrebuttal Appendix A. With regard to analysts' advice, the investor guide sums it up this way: "The important thing to remember is that you should never rely solely on an analyst recommendation when making an investment decision." The same is true for estimating the DCF cost of equity capital.

OCA St. 2-SR at 19. Accordingly, the OCA submits that Mr. Hill's growth rate is reasonable, well-supported and not "understated" as PPL alleges.

PPL next argues that Mr. Hill's DCF results should not be accepted to set rates in this matter because no "leverage adjustment" is included. PPL M.B. at 127-129. 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 St. 2 at 55-56; see also OCA M.B. at 60-63. 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 St. 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 St. 2 at 61. As Mr. Hill explained, the leverage adjustment proposed in this case is unnecessary, unreasonable and should be rejected. PPL argues that the Commission has not "shut the door on adopting a leverage adjustment." PPL M.B. at 108. The OCA submits that the Commission should consider doing just that.

No other regulatory jurisdiction accepts Mr. Moul's leverage adjustment, as Mr. Hill testified:

> [E]ven though Mr. Moul began to employ his leverage/risk adjustment in 1997, and this Commission, for a period of time, utilized that adjustment, Mr. Moul notes in his testimony (Moul Direct, p. 37) that the last time this Commission utilized that adjustment was 2007. As I noted above, since that time this Commission has rejected that adjustment. Moreover, since 2007 Mr. Moul has testified in 24 regulatory jurisdictions, and no regulatory jurisdiction (including Pennsylvania) has specifically accepted and utilized Mr. Moul's "leverage/risk" adjustment.

OCA St. 2 at 59. During the cross-examination of Mr. Moul, it was confirmed that the only regulatory jurisdiction to accept Mr. Moul's leverage adjustment proposal has been Pennsylvania. Tr. at 251. It should not come as a shock that Mr. Moul's leverage adjustment has been soundly rejected, because, as Mr. Hill testified, it is based on the unsupported assumption that one company, here PPL, can have two different levels of financial risk – at the same time. OCA St. 2 at 62. As Mr. Hill testified further:

> At page 29 of his Rebuttal, Mr. Moul admits that the parameter that causes financial risk—the interest payments (the actual cost of debt)—do not change no matter how the capital structure is measured. The question, then, is this: If the parameter that causes financial risk (interest payments) does not change, how can

> there be a change in financial risk? As Mr. Moul admits, there is no change in the parameter that causes financial risk (interest expense). If there is no change in financial risk, there is no need to "adjust" the cost of capital. Market value capitalization and book value capitalization are simply two different measures used to gauge the same financial risk. Those two measures cannot, with any meaning, be compared to each other in order to assess relative financial risk, as Mr. Moul would have it.

OCA St. 2-SR at 7.

The OCA has provided substantial evidence in this proceeding to show that the Commission, like every other regulatory body before it, should reject this unnecessary and unsupported leverage adjustment.

Finally, as to DCF issues, PPL alleges that Mr. Hill incorrectly chose the low end of his DCF results, 8.75 to 9.50, by recommending a 9.0% ROE. PPL M.B. at 127. PPL goes on to argue that this "error" can easily be rectified by adopting the top end of the range, 9.5, and then adding a leverage adjustment of 70 basis points for a total of 10.2%. PPL M.B. at 127-128. The OCA strongly opposes such adjustments, and submits that based on the evidence of record, such upward adjustments would result in rates that are unjust and unreasonable.

Mr. Hill testified as to the reasons he chose a 9.0% ROE, as follows:

> Because the capital structure I recommend for ratemaking purposes is similar to the capital structure for the sample group, PPL Electric Utilities will have similar financial risk to the sample group and should be awarded an equity return at the mid-point of a reasonable range. However, the equity cost estimates indicate that wires companies like PPL have lower investment risk than electric companies with generation assets. Therefore, an equity return of 9.0%, slightly below the mid-point of the 8.75% to 9.5% range would be reasonable for ratemaking purposes in this proceeding.

OCA St. 2 at 53. As Mr. Hill testified, PPL owns no generation and thus has a lower risk profile than the sample group as a whole. As to PPL's allegations that Mr. Hill's sample group having higher allowed accounting returns is support for a higher ROE for PPL, the Company has misinterpreted the data. Mr. Hill properly explained the correlation, as follows:

> If utility investors were paying market prices for utility stock that approximated their book value, Mr. Moul would have a point. If that were the case, then it would be reasonable to point to allowed accounting returns (ROEs) as indicators of the cost of equity capital. However, investors are providing market prices per share for their utility investments that substantially exceed the book value per share of those companies. Because the return the utilities are allowed is based on book value, that condition necessarily indicates that the investor-expected return (the cost of capital) is *below* the projected return on book value.
>
> Mr. Moul correctly points out that the companies in my electric sample group have average allowed to earn accounting returns (ROEs) of 10.4%. However, that does not support his thesis that my 9.00% equity cost estimate is too low. Rather it supports the reasonableness of that result. That is because investors are currently providing market prices for those companies that average about 30% more than book value. So, if an investor is paying 40% more than book value for a stock that is expected to earn a 10.4% return on book value, the return the investor expects to earn on the market price he or she provides (the cost of capital) must be well below 10.4%. Therefore, 9.00% is reasonable; and Mr. Moul's 11.25% recommendation for the cost of capital must be substantially overstated according to the allowed return data cited in Mr. Moul's Rebuttal.

OCA St. 2-SR at 15-16. As Mr. Hill explained, PPL's reliance on the sample group data is misplaced.

Mr. Hill's 9.0% ROE recommendation is well supported by the record in this case, and accordingly PPL's arguments on this point should be rejected.

b. <u>PPL's Request For A 12-Basis Point ROE Adder For Management Performance Should Be Rejected.</u>

The Company has requested that the Commission adopt a cost of equity for PPL that includes an additional 12 basis points for what has been described as PPL's "exemplary management performance." PPL St. 11 at 6. The OCA opposes the Company's request for a higher equity return rate on this basis. The Company's ratepayers have a right to receive safe and adequate service at rates which are just and reasonable, and to expect utility management to operate in an effective manner. 66 Pa. C.S. §§ 1301, 1501. The OCA recognizes that the Public Utility Code allows the Commission to "consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates." 66 Pa. C.S. § 523(a). The evidence of record here, however, does not support PPL's request.

In its main brief PPL opines that OCA, "without studying PPL Electric's management performance," argues against the ROE adder based on hard economic times. PPL M.B. at 122. OCA witness Hill did testify that an additional 12-basis point adjustment to ROE would be "unduly burdensome" for ratepayers, Tr. at 320, but the Company is wrong, however, in stating that "OCA" did not study or investigate PPL's claims of "exemplary management performance." The OCA would note that at the hearings PPL witness Moul was questioned about his personal knowledge relating to PPL's management performance. Mr. Moul testified that he had not done any investigation or analysis of same, and stated for instance, he had no knowledge of how many storm-related outages PPL had incurred or how long it may have taken to restore power after such outages. Tr. at 244. Mr. Moul testified for PPL as to the 12-basis point ROE adder based on PPL's alleged "exemplary management performance." PPL St. 11 at 6.

As to the OCA's investigation, during the hearings the OCA submitted as evidence OCA Cross Examination Exhibit 1.[9] Page 3 of OCA Cross Exhibit 1 lists 5 separate dockets where the Commission's Prosecutory Staff has investigated PPL for potential violations of the Public Utility Code in recent years. OCA Cross Exh. 1. In at least one of those dockets, the Commission stated that "PPL's alleged conduct was of a serious nature." Pa. PUC v. PPL Electric Utilities Corp., Docket No. M-2008-2057562, Order at 11 (May 31, 2009). Several of the other docket numbers listed in OCA Cross Exhibit 1 contain descriptions of events and incidents that do not represent "exemplary management performance."

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[9] OCA Cross Exhibit 1 contained a discovery response that was sponsored by PPL witness Dahl, who verified the authenticity of the document on the stand, and the Exhibit was later admitted into the record. Tr. at 561, 567.

Accordingly, the OCA submits that the evidence of record, taken as a whole, does not support PPL' request for a 12-basis point ROE adder.

c. Conclusion.

The Company's request for an 11.25 % return on common equity is excessive, would result in a shareholder windfall at the expense of ratepayers, is inconsistent with the current low-cost capital environment, and would result in rates that are unjust and unreasonable. The Commission should consider the reasonable range of the cost of common equity proposals submitted in this proceeding, based primarily on the DCF methodology, and adopt the OCA's recommended ROE of 9.0%.[10] In addition, based on the record evidence in this matter, PPL's request for a 12-basis point ROE adder for management performance should be rejected.

4. Conclusion.

For all of the foregoing reasons and the reasons set out in the OCA's Main Brief, the OCA submits that PPL has failed to meet its burden of proof in support of its request for this Commission to allow it the opportunity to earn a return on equity of 11.25%. Similarly, PPL's request for a 12-basis point ROE adder for management effectiveness should be rejected. Further, PPL has failed to show that its proposed capital structure containing 51% common equity should be adopted. The OCA recommends that this Commission adopt the cost of capital recommendations of Mr. Hill, and allow PPL the opportunity to earn a 9.00% return on common equity and a 7.19% overall return on its rate base.

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[10] See OCA M.B. at 47-64. Note that the OCA's recommended ROE of 9.0% is premised on the Commission accepting the OCA's recommended capital structure. Should the Commission decide to accept PPL's proposed capital structure with a significantly higher equity component, then the OCA recommends an ROE of 8.75%. See OCA St. 2 at 53.

F. Rate Structure.

Introduction.

In this section of its Reply Brief, the OCA responds to those parties who took a position in their Main Briefs as to the Cost of Service Study (COSS), Revenue Allocation, Scale Back and the Residential Customer Charge issues. As stated throughout this Reply Brief, it is not the OCA's intention here to restate each and every argument as detailed in its Main Brief, but rather to directly reply to opposing arguments raised by the other parties in their Main Briefs. Accordingly, the OCA relies on its Main Brief for a complete discussion of the OCA's position in this case.

As to the COSSs presented in this proceeding, the OSBA, PPLICA and Richards Energy support PPL's recommended COSS and Revenue Allocation proposals. In their respective Main Briefs, these parties provide support for PPL's COSS and Revenue Allocation, but, by and large, these supporting parties cover no ground that is not already covered by PPL in its Main Brief. Accordingly, the OCA will primarily focus here on its reply to PPL.

As to the separate allocation issue of a scale back, in the event that the Commission authorizes a revenue increase less than the total amount PPL requested, the OCA supports a proportional scale back based on its revenue allocation proposal. The OCA opposes the OSBA's recommended scale back, which would grant rate decreases to certain rate classes by allocating a revenue increase to the residential class that would be larger than the total amount PPL is granted. The OCA submits that such a method should not be considered in this proceeding.

The OCA also replies to PPL's request for a substantial increase in the customer charge for the RS class, from \$8.75 to \$16.00. The Company's proposal in this regard is unsupported by the record and should be rejected. The RS class customer charge should remain at its current level of $8.75.

1. Cost Of Service Study.

a. Introduction.

The Commission should adopt the OCA's recommended COSS as a reasonable guide to set rates in this proceeding. PPL's cost of service study is flawed because it does not accurately reflect cost causation, is inconsistent with the 1992 NARUC Manual and the updated 2000 NARUC Report, and is inconsistent with the historical method that PPL used prior to 2010. OCA witness Glenn Watkins' COSS properly allocates costs in a more accurate and reasonable manner, a manner that is reflective of cost causation, a manner that reflects how PPL's distribution system is actually used and a manner that is consistent with PPL's methodology that it used for approximately 30 years prior to 2010. In its Main Brief, for these reasons, the OCA proposed that the Commission reject the Company's COSS and rely primarily on OCA witness Watkins' cost analysis as a guide to set rates in this matter. See OCA M.B. at 66-91.

In its Main Brief, PPL argues that the OCA's criticisms of its recommended COSS should be rejected. PPL M.B. at 140-152. Specifically, PPL makes three arguments in opposition to the OCA's position: (1) PPL has accurately allocated its Primary distribution plant; (2) the use of a Minimum-Size Study is appropriate; and, (3) the OCA's adjustments to PPL's Minimum-Size Study are unnecessary. Id. The OCA will address each of these specific arguments in the following section.[11]

In addition to its specific arguments in opposition to the OCA position, the Company also makes generalized statements that rely heavily on the Commission's decision in the 2010 PPL

[11] The OCA notes that each of these issues was identified and thoroughly discussed in the OCA's Main Brief. See OCA M.B. at 66-91.

Rate Case[12] and PPL's claimed adherence to the strictures of the 1992 NARUC Manual. See e.g., PPL M.B. at 137-138.

Contrary to PPL's allegations, the OCA has not simply disregarded the findings of the ALJ and the Commission as to the COSS issue in PPL 2010. Rather, in preparation for this case the OCA witness reviewed and studied the findings there. In the OCA's view, the ALJ and the Commission adopted PPL's revised allocation of primary distribution plant in the 2010 case because it found it consistent with the 1992 NARUC Manual. In *this* case, as thoroughly discussed in the OCA's Main Brief and in the following sections of this Reply Brief, the OCA has created a full and complete evidentiary record to show that PPL's COSS is not in accord with the specific direction contained in the 1992 NARUC Manual in several areas. In fact, the 2000 NARUC Report shows that 30 other regulatory jurisdictions adhere to a COSS methodology very similar to what PPL used prior to 2010, and very similar to the OCA's recommended COSS. PPL's abrupt change of course, as reflected in its COSS method in PPL 2010, is the outlier.

One very important point is central to the entire discussion of COSS methodologies, and that is results. PPL agreed to bring all rate classes substantially to cost of service over a period of three rate cases, starting in 2004, including the 2007 rate case and concluding with PPL 2010. Using PPL's flawed COSS, however, this has not happened. Although the RS class was closing in on that objective in PPL 2010, the Company changed the rules of the game by switching to a COSS method where primary distribution plant costs are now substantially allocated based on the number of customers, and not based solely on demand as had been PPL's practice for

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12 Pa. PUC v. PPL Electric Utilities Corporation, Docket No. R-2010-2161694, (Order entered Dec. 21, 2010) (PPL 2010).

decades. The unreasonableness of such a method is aptly described by OCA witness Watkins, as he testified:

> Therefore, because customer counts do not recognize relative customer size difference or differences in utilization or demand, a small residential apartment customer is allocated the same level of costs as a major industrial factory.

OCA St. 3-SR at 2. During cross examination, PPL witness Kleha acknowledged that Mr. Watkins' example of how illogical it is to allocate costs in such a manner, is, in fact, accurate:

> Q. When distribution plant costs are based on number of customers, a small apartment customer would be allocated the same level of costs as a major industrial factory or a large office building complex; is that correct?
>
> A. Approximately, yes.

Tr. at 389-390. As further evidence of the major flaws in PPL's COSS method in PPL 2010, and in this case, one only needs to review the results of such a method.

Rate Classes	**Relative Return at Present Rates**	**Relative Return at Proposed Rates**
Total PA Jurisdictional	100.00%	100.00%
RS	53.10%	78.61%
RTS	-59.94%	-2.65%
GS-1	163.91%	113.17%
GS-3	360.73%	250.06%
LP-4	212.88%	145.20%
ISP	140.06%	135.83%
LP-5	-372.02%	-237.33%
LP-6	-1064.39%	-831.53%
LPEP	237.36%	163.51%
GH	217.81%	150.94%
SL/AL	145.47%	100.77%

Source: PPL 2010, Recommended Decision at 49-50 (Entered Oct. 15, 2010).

Rate Classes	Relative Return at Present Rates	Relative Return at 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%

Source: 2012 PPL M.B. at 154.

As the charts show, even though the residential class absorbed the entire $77.5 million revenue increase in PPL 2010, the last of the three base rate cases where PPL was to bring all rate classes substantially to cost of service, the RS class has made only limited "progress" toward that goal. Further, even though the residential class is once again being asked to shoulder the entire burden of PPL's requested $104.6 million increase, the RS class under PPL's flawed COSS still appears to fall short of the goal line. The OCA submits that continuing to follow this path, using PPL's flawed COSS, it will take several more base rate cases, with the residential class bearing the entire rate increase, to perhaps approach the finish line. The OCA submits that these results tend to show why 30 other regulatory jurisdictions do not use the method that PPL continues to propose here.

Accordingly, the OCA respectfully requests the ALJ and the Commission to reject PPL's invitation to simply extend the PPL 2010 holdings to the facts of record in this case.

It is critical to understand that the main controversy between the OCA and PPL is the treatment of primary distribution plant. Prior to 2010, PPL properly allocated primary distribution plant costs based 100% on demand, consistent with the OCA's recommended approach in this case and consistent with how primary distribution plant costs are allocated in over 30 other regulatory jurisdictions. In 2010, and in this proceeding, the Company completely changed direction and, for the first time, classified a majority of its primary distribution plant on a customer basis, resulting in a shift of over $1 billion of primary distribution plant costs to a customer count basis. Because residential customers greatly outnumber consumers in the other rate classes, the residential classes bear the vast majority of these costs, as evidenced by the fact that the residential classes have borne the brunt of PPL's substantial rate increases over the last number of years, and as discussed above, under PPL's biased COSS method the residential classes have little hope of relief at anytime in the foreseeable future, if ever.

Moreover, PPL's criticisms of the OCA's recommendation to classify primary distribution plant as 100% demand related are ironic, at best, considering that this is exactly how PPL treated primary distribution plant costs prior to 2010. In its Main Brief, PPL attempts to muddy the water on this situation by making generalizations about the "distribution system" as a whole, how PPL "based on long-standing practice and precedent" classifies distribution system as part demand and part customer, and has done so "at least for the last 30 years." See e.g., PPL M.B. at 141-143. These statements, however, are not in accord with the record in this case.

During the cross examination of PPL witness Kleha, the witness acknowledged that prior to 2010 PPL classified all primary distribution plant as demand related – there was no customer component. Tr. at 395. Mr. Kleha further acknowledged that starting in 2010 and continuing in this case, PPL now classifies primary distribution plant as customer/demand related. Tr. at 400-402. This major modification to PPL's COSS resulted in a shift of over $1 billion of primary distribution plant costs to a customer basis. The OCA submits this major unjustified revision to

PPL's COSS is not consistent with PPL's claimed "long-standing practice and precedent." PPL's claimed adherence to the 1992 NARUC Manual "since 1973" finds no support in the record of this case. Further, what the 1992 NARUC Manual actually recommends, as the record shows, is inconsistent with how PPL has conducted its COSS. See e.g. OCA St. 3 at 19-21.

b. PPL's Classification Of The Majority Of Primary Distribution Plant As Customer-Related Is Unsupportable And Biased To The Residential Class.

In its Main Brief, PPL agrees that the main point of contention between the OCA and PPL is the allocation of primary distribution plant costs. PPL M.B. at 140. PPL then goes on to argue that the OCA is incorrect that distribution plant should be allocated based only on demand, and that the 1992 NARUC Manual does not dictate such a result. PPL M.B. at 140. The OCA submits that it has provided substantial evidence in this case to show that it is indeed reasonable, and, in fact, the standard method, to allocate all distribution plant based on demand. As OCA witness Watkins testified:

> With respect to embedded cost analyses this updated NARUC report states:
>
> > There are a number of methods for differentiating between the customer and demand components of embedded distribution plant. The most common method used is the basic customer method, which classifies all poles, wires, and transformers as demand-related and meters, meter-reading, and billing as customer-related. This general approach is used in more than thirty states. A variation is to treat poles, wires, and transformers as energy-related driven by kilowatt-hour sales but, though it has obvious appeal, only a small number of jurisdictions have gone this route.

OCA St. 3 at 20; see also 2000 NARUC Report at Schedule GAW-4, pgs. 3-4 (emphasis added). Contrary to PPL's assertions, the allocation of both primary and secondary distribution plant based only on demand is fully supported as OCA witness Watkins testified. In this case, however, and in order to reduce controversy, the OCA has recommended a COSS that aligns with PPL's method prior to 2010 and focuses on the allocation of primary distribution plant.

As discussed, prior to 2010, PPL classified primary distribution plant as 100% demand related. Tr. at 395. This treatment of primary distribution plant costs PPL now alleges "makes no sense" and "demonstrates" a "lack of merit." PPL M.B. at 141. In the 2010 case, and here, PPL has classified primary distribution plant as 63% customer and 37% demand related. PPL has classified secondary distribution plant as 62% customer and 38% demand related. Mr. Watkins explained the difference in primary and secondary plant, as follows:

> PPL's overall distribution system is comprised of a primary voltage system and a secondary voltage system. The primary system operates at higher voltage levels than the secondary system and generally consists of plant and equipment between the substations and transformers. The lower voltage secondary system can be thought of as operating downstream from the primary system and delivers electricity to small end-users.

OCA St. 3 at 14-15. Mr. Watkins provided evidence to show that both primary and secondary distribution plant should be classified as 100% demand related, consistent with how regulatory bodies in over 30 states classify such plant. See e.g. OCA St. 3 at 20-21.

In this case, however, Mr. Watkins has recommended a reasonable compromise COSS that maintains a customer/demand split for the secondary distribution plant and treats all primary distribution plant as demand related. Specifically, Mr. Watkins COSS classifies primary distribution plant exactly how PPL did prior to 2010 – 100% demand related. Mr. Watkins then classifies secondary distribution plant as partially demand and partially customer related, as in PPL's current and prior COSSs, but Mr. Watkins uses a more appropriate customer component than PPL based on his revisions to Mr. Kleha's minimum size study and consistent with how such a study is to be performed as per the 1992 NARUC Manual. See OCA St. 3 at 36-37.

PPL next argues that Mr. Watkins' customer density analysis provides no support for the OCA's contention that all primary distribution plant costs should be allocated based only on demand. PPL M.B. at 142-145. PPL's key argument on this point is that the OCA's proposal to allocate 100% of primary distribution plant based on demand was not accepted by the Commission in 2010. PPL M.B. at 142. The OCA agrees that in PPL 2010, the Commission did not accept the OCA's recommended treatment of primary distribution plant. The OCA would point out, however, that prior to 2010 the Commission did accept PPL's treatment of primary distribution plant as being 100% demand related – exactly as the OCA recommends here. The OCA would further point out that just like PPL prior to 2010, at least 30 other regulatory jurisdictions treat primary distribution plant as 100% demand related. Accordingly, Mr. Watkins' customer density analysis is an important element of evidence in this case.[13]

Mr. Watkins explained the purpose of his study, in relevant part as follows:

> As a hypothetical, suppose a utility serves both an urban area and a rural area. In this situation, many customers' electrical needs are served with relatively few miles of conductors, few poles, etc. in the urban area, while many more miles of conductors, more poles, etc. are required to serve the requirements of relatively few customers in the rural area. If the distribution of classes of customers (class customer mix) is relatively similar in both the rural and urban areas, there is no need to consider customer counts (number of customers) within the allocation process, because all classes use the utility's joint distribution facilities proportionately across the service area. However, if the customer mix is such that Commercial and Industrial customers are predominately clustered in the urban area, while the rural portion of the service territory consists almost entirely of Residential customers, it may be unreasonable to allocate the total Company's investment based only on demand; i.e., a large investment in many miles of line is required to serve predominately Residential customers in the rural area while the Commercial and Industrial electrical needs are met with much fewer miles of lines in the urban area. Under this circumstance, an allocation of costs based on a weighting of customers and demand can be considered equitable and appropriate.

OCA St. 3 at 8-9. As Mr. Watkins explained, if a utility's service territory contains relatively clear lines of demarcation, such that business and industry is clustered in the urban areas and residential customers are clustered in more rural locations, then allocating distribution system costs based in part on a customer component has some legitimacy. After a thorough analysis of

13 Mr. Watkins' customer density study supports the treatment of primary and secondary distribution plant as 100% demand related, but, here, to focus on the key drivers of cost the OCA is advocating only that primary distribution plant should be treated as 100% demand related. See OCA St. 3 at 8-20.

PPL's service territory, Mr. Watkins concluded that such clustering of customer classes is not present. OCA St. 3 at 9-18. Mr. Watkins explained his findings, as follows:

> PPL's customers are dispersed in a reasonably proportional manner throughout its service area.
>
> [T]here is no distinct differences in the mix of customers (by class) across the rural and urban portions of PPL's service area. The relationship of Residential customers relative to non-Residential customers is relatively constant throughout PPL's service area. While the rural areas of PPL's service area are comprised Mainly of Residential customers, this relationship also remains true for the more dense population areas of PPL's territory as well. More importantly, in the less dense portions of PPL's service territory (rural areas), PPL serves a proportionate number of GS-1, GS-3, GH-2, and LP-4 (non-Residential) customers.
>
> In summary, each customer class is represented in a reasonably proportional manner in both rural and urban areas within PPL's service area. As a result, it cannot be said that the less populated portions of PPL's service area (which require significant investment to serve few customers) are dedicated to any one class of customers. As such, PPL's distribution plant and expenses should be assigned to classes based only on utilization and any consideration of customer counts is improper for the allocation of distribution plant, as such, this study indicates that PPL's distribution plant should be classified as 100% demand-related.

OCA St. 3 at 18.

PPL argues that "OCA's geographic customer mix by rate class analysis does not address the issue of whether a customer component is appropriate." PPL M.B. at 144. The OCA submits that PPL is incorrect in this assertion, as the issue of whether a customer component is appropriate or not for use in allocating PPL's primary and/or secondary distribution plant costs is exactly what Mr. Watkins' study focuses on. Mr. Watkins customer density analysis provides evidence to show that all of PPL's distribution plant could reasonably be allocated based 100% on demand. To be clear, however, this is not the OCA's recommendation. Mr. Watkins presented a compromise COSS that allocates primary plant as 100% demand related and then allocates secondary plant based on a reasonable customer/demand split.

As to PPL's arguments that the OCA's COSS is not supported in the 1992 NARUC Manual, the record clearly shows otherwise. As discussed previously, the OCA's recommended COSS in this proceeding uses the exact same method as PPL did prior to 2010. If PPL is correct that it has "followed the actual guidance provided in the NARUC Manual since 1973", then it is obvious that the OCA's current COSS finds support therein. PPL M.B. at 145. The OCA submits that Mr. Watkins' testimony as to the import of the 1992 NARUC Manual is most instructive on this point, in relevant part:

> Indeed, like all reference guides, the NARUC Manual is not intended to be a one-size-fits-all cookbook, but rather a guide to the application of various procedures depending on specific circumstances. In order for the Commission to be fully informed as to what the NARUC Manual does and does not recommend, the entire chapter concerning the classification of distribution plant is provided in my Schedule GAW-3.

OCA St. 3 at 19-20. As Mr. Watkins explained, the 1992 NARUC Manual is a useful guide, but it cannot be exclusively relied on to conform to and resolve every matter concerning the creation or application of COSSs.[14]

As Mr. Watkins testified further on this issue:

> Furthermore, the 1992 NARUC Manual was written in an era when all retail utility services were bundled (generation, transmission and distribution). Subsequent to the unbundling of retail rates in the mid to late 1990's by several state jurisdictions, NARUC commissioned a study to examine the costing and pricing of electric distribution service in further detail. In December 2000, NARUC published a report entitled: <u>Charging For Distribution Services: Issues in Rate Design</u>. As part of the Executive Summary this report states:
>
> > The usefulness of cost analyses of the distribution system in designing rate structures and setting rate levels depends in large measure upon the manner in which the studies are undertaken. Cost studies (both marginal and embedded) are intended, among other things, to determine the nature and causes of costs, so that they can then be reformulated into rates that cost-causers can pay.

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[14] The 1992 NARUC Manual does, however, provide specific instruction on performing a minimum size study. In this case, as Mr. Watkins testified, PPL failed to follow such direction. <u>See</u> OCA St. 3 at 25-36; <u>see also</u> OCA M.B. at 85-91. The OCA's recommended COSS accurately tracks the 1992 NARUC Manual in this regard.

> Such studies must of necessity rely on a host of simplifying assumptions in order to produce workable results; this is especially true of embedded cost studies. Moreover, it is often the case that many of the costs (*e.g.,* administrative and general) that distribution rates recover are not caused by provision of distribution service, but are assigned to it arbitrarily. Too great dependence on cost studies is to be captured by their underlying assumptions and methodological flaws. Utilities and commissions should be cautious before adopting a particular method on the basis of what may be a superficial appeal. More important, however, is the concern that a costing method, once adopted, becomes the predominant and unchallenged determinant of rate design. (page 67)

OCA St. 3 at 20 <u>citing</u> the 2000 NARUC Report. The 2000 NARUC Report additionally provides that:

> Traditionally, customer costs are those that are seen to vary with the number of customers on the system service drops (the line from the distribution radial to the home or business), meters, and billing and collection. Some utilities and jurisdictions also include some portion of the primary and secondary distribution plant (poles, wires, and transformers) in these costs, on the ground that they also are driven more by numbers of customers than by demand or energy. Similar reasoning leads to the designation of the costs of customer service and customer premises equipment as customer-related. <u>But, since the system and its components are sized to serve a maximum level of anticipated demand, the notion that there are any customer costs (aside from perhaps metering and billing) that are not more properly categorized as demand can be challenged.</u>

OCA St. 3, Schedule GAW-4 at pg. 3 (emphasis added). As the 2000 NARUC Report provides, the distribution system is designed and sized, not simply to connect customers, but to serve peak demands. Consistent with the OCA's recommended COSS, this fact is especially relevant to the higher-voltage primary distribution system. The OCA submits that the 2000 NARUC Report is an additional, useful piece of evidence for the Commission to consider in its review of this matter.

In its Main Brief, PPL questions whether in fact the 2000 NARUC Report is actually a statement of NARUC policy, and whether it is or not, PPL alleges that the OCA's reliance on it is misplaced. PPL M.B. at 145. As to the authenticity of the 2000 NARUC Report, Mr. Watkins testified as follows:

> I will also note that in the same acknowledgement, the authors note that they received considerable guidance with - - well, I'll read it to you. This paper could not have been written without the guidance, insights and thoughtful comments of many people. The review given by the members of the staff of NARUC Committee on Energy Resources and the Environment was invaluable.
>
> There's no sense in bickering over -- is this an official NARUC document? Of course, it is. I purchased it from NARUC. It's only available through NARUC. I guess you were lucky to get one from the authors. They charge handsomely for it. It's used widely in the industry. The four or five authors are -- their credentials and integrity are impeccable. They're all former commissioners. It's a widely used document.

Tr. at 518-519. As Mr. Watkins testified, the 2000 NARUC Report was commissioned by NARUC, it is an examination of issues as to rate design in a post-restructured electric utility world, and the credentials of the authors are beyond reproach. Whether or not this is an "official" NARUC document, as PPL seems to hang its hat on, the Report itself is clear that this is a relevant, useful piece of information that should be considered in this matter.[15] As to PPL's second argument that the 2000 NARUC Report does not lend support for the OCA's position because it is based on marginal pricing principles, the OCA disagrees. PPL M.B. at 145.

During cross examination, OCA Witness Watkins responded to the question of whether the authors rely primarily on marginal pricing analysis, as follows:

> No. As you will read the document, there is a section devoted to marginal cost pricing and a section devoted to embedded cost pricing, fully allocated cost like we traditionally do here in Pennsylvania. There are two sections to the report, one on marginal cost pricing and one on embedded pricing. Are they advocates of marginal cost pricing? Clearly, as most economists are.

Tr. at 520. As Mr. Watkins clarified, the 2000 NARUC Report is relevant to this matter.

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15 A copy of the entire Chapter IV from the 2000 NARUC Report discussing costing studies is provided in OCA St. 3, Schedule GAW-4.

In conclusion, PPL's attempts to discredit the OCA's recommended COSS in this proceeding ring hollow. There can be no reasonable debate that the OCA's recommended COSS is consistent with the general guidelines contained in the 1992 NARUC Manual, the 2000 NARUC Report, PPL's own long-held COSS methods prior to 2010 and consistent with how primary distribution plant costs are allocated in over 30 regulatory jurisdictions. PPL's "adjustments" to its COSS starting in 2010, and continuing here have resulted in over $1 billion of primary distribution plant costs being allocated on a customer component. It is clear how PPL's new allocation method has adversely affected and is biased to the residential class, as the 2010 rate case provides:

> Using the PPL 2004/2007 Method, where Primary distribution plant is classified as 100% demand-related, the residential return at current rates was 5.23%. OCA St. 3-S at 7. Using the PPL 2010 Method, where Primary distribution is classified substantially as customer related and only partially as demand-related, the residential return was 3.12%.

PPL 2010, Recommended Decision at 42 (Oct. 15, 2010). Fast forward to this case where PPL's 2010 method is being proposed, and the RS class has a rate of return of 3.87% at current rates under PPL's COSS, but under the OCA's COSS (substantially similar to PPL's method prior to 2010) at present rates the RS class has a return of 6.90%. See OCA St. 3 at 35, 37. PPL's proposed COSS results in a huge shift of costs to the residential classes and is inconsistent with the principles of cost-causation and basic fairness. Conversely, the OCA's recommended COSS is reasonable, consistent with industry norms and produces fair results for all rate classes. The OCA submits that PPL's arguments to the contrary should be rejected.

c. Even If A Partial Customer Classification Of Distribution Plant Is Appropriate, The Company's Minimum System Study Used To Determine The Customer Percentage Is Flawed.

As shown by the customer density analysis undertaken by OCA witness Watkins, PPL's classification of the majority of primary and/or secondary distribution plant costs based on the number of customers is not reasonable and should not be accepted in this proceeding. Even if a customer component is used, however, the Company's minimum size study is flawed in several respects as to determining the appropriate level of the customer/demand split. Mr. Watkins corrected the Company's flawed minimum size study and made several adjustments strictly in accordance with specific instruction given in the 1992 NARUC Manual. Accordingly, Mr. Watkins' results have produced a reasonable customer/demand split for the allocation of secondary distribution plant costs that should be used in this proceeding.

In its Main Brief, PPL argues that the OCA's criticisms of its minimum size study are unfounded and the OCA's adjustments to the study are unnecessary. PPL M.B. at 146-152. Mr. Watkins testified as to the use of a minimum size method, as follows:

> In general, if a customer/demand weighting is appropriate, I prefer to use the zero-intercept method when possible. However, as with most aspects of ratemaking, there is not a universally accepted formula. The major criticisms I have regarding the minimum-size method are that unless adjusted, this method overstates the customer percentage because even the smallest installed size is used to meet the required level of peak demand. The primary weakness of the zero-intercept method is that more data and a good working knowledge of statistical linear regression analyses are required. Furthermore, data limitation may negate the credibility of either result but tend to be more pronounced with the zero-intercept method.

OCA St. 3 at 24.[16] As Mr. Watkins testified, the minimum size method requires certain adjustments to account for the fact that even the smallest element of distribution plant has some load carrying capability.

PPL claims that the application of its minimum size study is in accord with the 1992 NARUC Manual. PPL M.B. at 147. PPL also states "[t]he fact that some equipment in the Company's minimum size system has some nominal capability to carry load provides no basis for rejecting it." Id. PPL misses the point. It is not the fact that some load carrying capability is present, as Mr. Watkins explained this is a normal and expected result of using the minimum size method. The serious flaw in PPL's study is the fact that no adjustments were made to correct for this load carrying capability and the fact that the equipment chosen by PPL to represent its minimum size distribution system actually have significant load carrying capabilities, which require adjustments in order to avoid the result of having too heavy a customer component.

The failure to adjust for the load carrying capability of PPL's minimum size distribution system and the use of distribution plant for the study that carry significant consumer loads are major flaws in PPL's minimum size study, as Mr. Watkins explained:

> As a general matter, Mr. Kleha's minimum-size classification studies do not recognize the load (KW) that is actually available and carried by the predominant minimum-size equipment on PPL's system. Although this will become more apparent when I discuss Mr. Kleha's classification studies in detail by account, the minimum sizes of plant selected by Mr. Kleha serve significant load requirements of consumers and are universally considered to be demand-related, such that the customer portion of a distribution system should reflect only those costs required to connect a customer with no load placed on the system. This concept has been recognized by this Commission in prior cases. For example, in a 1985 Duquesne Light case, the Commission recognized this concept when it stated:

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[16] Mr. Watkins noted in his testimony that he could not perform a zero-intercept study for presentation in this proceeding as PPL record keeping is not conducive to the amount and granularity of data necessary to perform a credible and reliable zero-intercept analysis. OCA St. 3 at 27.

> The customer component of distribution plant is a theoretical minimum size system that is required to serve a customer with infinitely small load and represents the costs of just being a customer. This system can be represented as a wet thread supported by long tooth picks to serve a Christmas tree light. Pa. P.U.C. v. Duquesne Light Co., 59 Pa PUC 67, 160-61 (1985).

> Similarly, the NARUC Electric Utility Cost Allocation Manual also recognizes the load carrying capability of the minimum-size equipment installed in a distribution system as follows:
>
> > When using this [minimum-size] distribution method, the analyst must be aware that the minimum-size distribution equipment has a certain load-carrying capability, which then can be viewed as a demand-related cost (page 95).
>
> With the exception of Line Transformers (which represents less than 10% of PPL's gross investment in distribution plant), Mr. Kleha's classification studies make no attempt in correcting for, or adjusting this bias.

OCA St. 3 at 26. PPL's minimum size study is unsuitable for use in this proceeding as PPL has proposed it, as the methods employed are not in accord with the 1992 NARUC Manual as PPL claims.

The remainder of PPL's disagreement with OCA's reworking of its minimum size study relates to the individual components of distribution plant that Mr. Watkins made adjustments to, in complete compliance with the specific direction contained in the 1992 NARUC Manual, as discussed next.

As discussed above, PPL's minimum size study fails to account for the load carrying capacity of the minimum distribution plant components that were used in the study. As Mr. Watkins testified, failing to make adjustments for this fact results in an allocation that is too heavily weighted to a customer component, as opposed to a demand component. OCA St. 3 at 24. Further complicating this flaw in PPL's minimum size study is the fact that the distribution plant components that PPL has chosen to represent its minimum size distribution system are, quite simply, oversized. PPL's minimum size distribution system is hardly the "wet thread supported by long tooth picks to serve a Christmas tree light." Pa. PUC v. Duquesne Light Co., 59 Pa PUC 67, 160-61 (1985). Accordingly, Mr. Watkins made the necessary adjustments to the Company's minimum size study, starting with pole sizes used.

Mr. Watkins testified as to why PPL's use of 40-foot poles in its minimum size distribution plant is in error, as follows:

> In Exhibit JMK-3, Mr. Kleha states that "A 40-foot wood pole is the 'minimum-size' pole currently being installed on the PPL system." Mr. Kleha then used the embedded average cost per 40-foot pole of $595.87 on pages 13 and 14 of JMK-3 to develop his customer/demand splits for primary (page 14) and secondary (page 13) poles.
>
> In response to OCA Data Request V-27, Attachment 2, PPL provided details of its purchases of poles during the most recent 12-month period (April 2011 through March 2012). In this response, it was determined that PPL currently purchases a significant number of poles under 40-feet in length. This response shows that 17% (1,388 out of 8,314 total) of PPL's recent purchases were for poles of 25, 30, and 35-feet in length. Furthermore, in response to OCA Data Request V-13, PPL's records indicate a significant number of poles in service less than 40-feet, having the following average embedded costs per pole:
>
> Table 9
>
> | Pole-Size | Number of Poles | Avg. Cost Per Pole |
> |---|---|---|
> | 25 ft. and under | 11,026 | $356.60 |
> | 30 ft. | 114,228 | $485.43 |
> | 35 ft. | 143,463 | $465.39 |
>
> In order to be conservative, I substituted Mr. Kleha's selected average cost for a 40-foot pole of $595.87 with the average cost of 35-foot poles of $465.39. This change in the cost of a "minimum-size" pole results in the following minimum-size customer/demand splits for Account 364:

Table 10

	Account 364 (Poles) Minimum-Size Study			
	PPL Results		OCA Results	
	Customer	Demand	Customer	Demand
Primary System	51.38%	48.62%	40.13%	59.87%
Secondary System	75.00%	25.00%	58.58%	41.42%

OCA St. 3 at 28-29.

In its Main Brief, PPL argues that Mr. Watkins' adjustment for pole sizes is misplaced because PPL only uses poles less than 40 feet for specialized uses and the use of such shorter poles is limited. PPL M.B. at 151. As is clear from the Company's response to discovery, PPL purchases a large quantity of poles under 40 feet in length, inconsistent with its statements that such poles have only a limited use on the PPL distribution system. Further, the minimum size study should represent just that – the bare minimum plant necessary to connect customers and larger poles are certainly not needed nor should they be included for this purpose. Mr. Watkins' adjustment in this regard is reasonable and should be accepted.

Mr. Watkins' next adjustment was to overhead conductors. Mr. Watkins explained why PPL's chosen minimum size conductor is problematic, as follows:

> Mr. Kleha states in Exhibit JMK-3 that 1/0 aluminum is the minimum-size conductor currently being installed on the PPL system. In response to OCA Data Request V-27, Attachment 3, PPL provided its most recent 12-month purchases of conductor cabling. It was observed from this response that while 1/0 aluminum cable is the most common cabling currently purchased (749,665 linear feet), a significant amount of smaller ACSR #2 bare aluminum cable is currently being purchased (193,765 linear feet), at a somewhat lower per unit (footage) cost. However, the current unit costs of the cabling provided in response to OCA Data Request V-27 only reflect material costs (as requested) and do not reflect the capitalized labor portion of installing conductors which is ultimately booked and reflected in PPL's property records. In this regard, PPL's record keeping practices groups various sizes of conductors such that the smallest grouping

includes all conductors 1/0 and below. Therefore, it is not possible (with the data provided) to determine the average booked cost of PPL's "minimum-size" wire. As such, Mr. Kleha utilized the weighted average cost per linear foot of this "1/0 and below" (aluminum only) as a surrogate for minimum-size wire. While I realize the practical limitations due to readily available data constraints, I also note that a bias against small volume classes is created as a result of these limitations.

OCA St. 3 at 29-30. Mr. Watkins then went on to testify as to why this overhead conductor issue creates a significant bias against the small volume classes:

PPL's primary system is comprised of more than 382 million linear feet of energized conductor cables. Size 1/0 and below constitutes more than 280 million feet (73%) of this amount. A similar relationship exists for PPL's secondary system. In other words, about three-quarters of PPL's distribution system, with a combined NCP distribution load of about 7.1 MW is comprised of conductors that Mr. Kleha's analysis assumes is required simply to connect customers with no load carrying capability. As demonstrated above, this aspect of Mr. Kleha's analysis severely overstates the customer percentage of conductors and results in a significant cost allocation bias against Residential and Small Commercial customers.

OCA St. 3 at 30.

In its Main Brief, PPL claims that the use of smaller conductors is limited on its system and there is no adjustment necessary as Mr. Watkins claims. PPL M.B. at 151-152. The OCA notes, that as Mr. Watkins testified, during the last 12 months PPL has purchased approximately 750,000 linear feet of 1/0 aluminum conductors (the type used in PPL's minimum size system study) and purchased approximately 200,000 linear feet of ASCR #2 conductors. The OCA submits that the significant purchases of smaller conductors than what PPL claims is the "minimum" size actually used on its system provides support for Mr. Watkins' claims in this area.

This is only part of the overhead conductor issue, however, as Mr. Watkins explained:

The next aspect of my explanation concerns recognition (or lack thereof) of circuitry. For a minimum-system, a circuit requires two conductors. However, because electric utilities distribute power using single and three-phase circuits,

> and because of grounding practices, three-wire and four-wire circuits are often utilized. With this understanding, PPL Maintains its property records on a linear foot of cable, not circuit basis such that the quantity (feet) and cost of conductors is not Maintained on a size of circuit basis. The above circuitry discussion is important as it relates to the calculations required to perform a minimum-size analysis as per the NARUC Manual.
>
> When a minimum-size study is performed, the NARUC Manual states as follows:
>
>> Multiply average installed book cost per mile of minimum size conductor by the number of **circuit miles** to determine the customer component. Balance of plant account is demand component. **(Note: two conductors in minimum system).** [Page 91 (emphasis added)]
>
> Mr. Kleha's calculations do not reflect or consider the above referenced aspect of the NARUC minimum-size approach, but rather, reflects the linear feet of various multiple cable circuits within his development of the customer component which again, produces a distinct bias against Residential and small volume user classes. Based on the information provided in Exhibit JMK-3 and response to OCA Data Request V-13, I have modified the Company's minimum-size analyses to reflect a two-wire minimum circuit.

OCA St. 3 at 30-31. As Mr. Watkins has shown, PPL's minimum size study is inconsistent with the specific directions contained in the 1992 NARUC Manual, and produces results that are biased against the residential classes.

In its Main Brief, PPL argues that its record keeping practices are compliant with FERC's Uniform System of Accounts and that PPL does not account for conductors on a circuit foot basis. PPL M.B. at 149. PPL also claims that Mr. Watkins' recommendation that a two wire system is needed to represent the minimum size system is incorrect, as such a system would be hypothetical and not represent PPL's actual system. PPL M.B. at 150-151.

Whether or not PPL's record keeping is compliant with FERC standards or not is not the point here. PPL repeatedly claims adherence to the 1992 NARUC Manual, but the record here shows that this is not the case. As Mr. Watkins explained, the 1992 NARUC Manual, in this regard, provides detailed instructions on how to perform a minimum size study and exactly how to treat overhead conductors in such a study. Mr. Watkins has followed the 1992 NARUC Manual, made the necessary adjustments to the Company's minimum size system study and such adjustments should be accepted.

As one further issue on the treatment of overhead conductors, PPL included fiber optic cables in this category. Mr. Watkins explained why this is inappropriate, as follows:

> Finally, Mr. Kleha has included and treated fiber optic communications cable as if this cabling was energized to conduct electricity. In other words, Mr. Kleha's minimum-size analysis includes telecommunication fiber optic cabling as if they were electrical conductors cable capable (and used) of carrying amperage (current). I have excluded fiber optics cable within the calculations used to distinguish between a minimum-size customer and demand component.

OCA St. 3 at 31. PPL argues in its Main Brief that fiber optic cables are required for communication purposes and as such are necessary for the safe and reliable operation of the distribution system. PPL M.B. at 150. The OCA has no disagreement with PPL as to the need for communication devices, but fiber optic cables are not used to connect customers or supply electrical power to customers. As such, fiber optic cables have no place in the creation of a minimum size distribution plant for purposes of conducting a minimum size study. Mr. Watkins' adjustments to remove fiber optic cable are reasonable and should be accepted.[17]

d. Conclusion.

PPL's cost of service study is seriously flawed because it does not accurately reflect cost causation, is inconsistent with the 1992 NARUC Manual, the updated 2000 NARUC Report and with the historical method that PPL has used prior to 2010. OCA witness Watkins' study properly allocates costs in a more accurate and reasonable manner that is reflective of cost

[17] As part of the process of reworking PPL's minimum size study, Mr. Watkins also made adjustments to Account 366, Underground Conduit, and Account 367, Underground Conductors. See OCA St. 3 at 32-33. PPL did not address these OCA adjustments in its Main Brief.

causation on the PPL system. For these reasons, the OCA proposes that the Commission reject the Company's study and rely primarily on OCA witness Watkins' cost analysis as a guide to set rates in this matter.

2. Revenue Allocation.

The OCA recommends a revenue allocation that reflects the results of a properly conducted, reasonable and equitable COSS. In addition, the OCA submits that while cost of service should guide the Commission when setting rates in this proceeding, other ratemaking principles such as gradualism, avoidance of rate shock and basic fairness must not be abandoned. The Commission must consider the reasonable cost of service evidence presented in this proceeding as a guide for achieving the goal of the Lloyd settlement to move classes "at or near" cost of service while respecting principles of gradualism.[18]

The OCA submits that the revenue allocation proposed herein by Mr. Watkins meets the legal requirements for determination of revenue allocation. In explaining his revenue allocation, Mr. Watkins testified as follows:

> [G]iven the magnitude of PPL's proposed overall increase, I recommend no revenue decreases such that there will be no change in revenue for the GS-1 and LPEP classes even though their ROR's at current rates exceed those of PPL's proposed 8.46% cost of capital. Next, consistent with gradualism, I recommend that no class sustain an increase greater than 150% of the system-wide percentage increase in distribution base rates; i.e., no more than 21.45% (150% of 14.30%). These capped increases are applied to those classes that are significantly deficient in terms of ROR at current rates and include rates RTS, LP-4, LP-5 and GH-2. The remaining classes (rates RS, GS-3 and SL/AL) are then first brought up to full cost of service; i.e., ROR equals 8.46%. The remaining required increase is then distributed to rates RS, GS-3 and SL/AL based on current rate revenues.

[18] The Lloyd decision and subsequent settlement, *inter alia*, resulted in PPL agreeing to move its distribution rates to "at or near" the full cost of providing service over the next three rate cases. See Tr. at 399. Under the OCA's recommended COSS, this objective has already been achieved for the RS class.

OCA St. 3 at 39-40. Mr. Watkins' proposed revenue allocation reasonably moves all classes closer to their full cost of service, while at the same time respecting principles of gradualism and basic fairness. OCA St. 3 at 41.

Mr. Watkins provided the following table of his recommended allocation at the Company's full request:

Table 20

Comparison of OCA and PPL Proposed Increases ($000)

Class	OCA Increase $	OCA Increase Percent	PPL Increase $	PPL Increase Percent
RS	$65,854	13.96%	$101,088	21.42%
RTS	$961	21.45%	$3,568	79.61%
GS-1	$0	0.00%	$815	1.13%
GS-3	$25,045	20.29%	-$4,674	-3.79%
LP-4	$7,266	21.45%	$7	0.02%
LP-5	$258	21.45%	$712	59.28%
LPEP	$0	0.00%	$0	0.00%
GH-2	$290	21.45%	$323	23.86%
SL/AL	$4,943	21.45%	$2,779	12.06%
Total	$104,617	14.30%	$104,618	14.30%

OCA St. 3 at 41. As to the indexed rate of return at present rates and under the proposed increase, using Mr. Watkin's COSS and allocation provides the following results:

Table 16

	OCA CCOSS Results At Current Rates	
Class	ROR	Indexed ROR
RS	6.90%	112%
RTS	-5.71%	-93%
GS-1	11.05%	180%
GS-3	6.38%	104%
LP-4	-0.81%	-13%
LP-5	-5.37%	-88%
LPEP	24.48%	399%
GH-2	1.86%	30%
SL/AL	5.58%	91%
Total Jurisdictional	6.14%	100%

Table 21

	OCA Revenue Allocation	
Class	ROR	Relative ROR
RS	9.42%	111%
RTS	-4.51%	-53%
GS-1	11.05%	131%
GS-3	9.20%	109%
LP-4	0.93%	11%
LP-5	-0.34%	-4%
LPEP	24.48%	289%
GH-2	4.24%	50%
SL/AL	9.36%	111%
Total	8.46%	100%

OCA St. 3 at 37, 41. As the Tables above show, using Mr. Watkins COSS and revenue allocation method results in a reasonable movement of all classes to cost of service at PPL's proposed revenue increase, while also recognizing the need for gradualism.

In its Main Brief, PPL alleges that the OCA's COSS, and thus its revenue allocation should be rejected because it: (1) fails to properly allocate all costs to serve to the residential class; (2) is based on the assumption that there is no customer component of distribution plant; (3) is contrary to the 1992 NARUC Manual; (4) is contrary to "general industry practices"; (5) is contrary to prior Commission decisions as to PPL Electric; and (6) OCA's criticisms of PPL's minimum size study are not supported by the record and are inconsistent with the 1992 NARUC Manual. PPL M. B. at 155-156.[19] The OCA has addressed these issues more fully in the preceding sections of this Reply Brief, but will briefly address these claims, as they affect revenue allocation, in the following.

The OCA has submitted substantial evidence in this proceeding to show that primary and secondary distribution plant costs could reasonably be allocated 100% on demand, consistent with how such costs are allocated in over 30 other regulatory jurisdictions. After a thorough review and analysis of this evidence, however, Mr. Watkins chose to recommend a compromise COSS. The OCA recommended COSS allocates primary distribution plant based 100% on demand. This approach is not inconsistent with the general guidance provided in the 1992 NARUC Manual and is consistent with general industry practice in over 30 other regulatory jurisdictions. The OCA submits that the allocation of primary distribution plant based 100% on demand is not inconsistent with prior Commission decisions as to PPL, save for the lone example of PPL 2010, as this is the exact method used by PPL prior to the 2010 case.

As to the OCA's compromise COSS, after allocating primary distribution plant based 100% on demand, Mr. Watkins allocated secondary distribution plant based on a reasonable and appropriate demand/customer split. Clearly, the OCA has recommended some portion of

[19] Consistent with the Cost of Service Study issue, the OSBA, PPLICA and Richards Energy support PPL's proposed revenue allocation. See OSBA M.B. at 9-15; PPLICA M.B. at 13-17; Richards Energy M.B. at 5. These parties' Main Briefs cover the same areas as PPL, and as such, the OCA's reply here will focus on the Company.

distribution plant be allocated based on a customer component. Mr. Watkins arrived at this demand/customer split for the secondary distribution plant after review, analysis and a substantial reworking of PPL's minimum size study – all done completely consistent with the 1992 NARUC Manual. The OCA submits that the record in this matter is clear as to the serious flaws in PPL's minimum size study as it was presented by PPL in this matter.

PPL's claim that the OCA has failed to allocate all of the costs incurred to serve the residential class to that class is baseless. As discussed throughout this Reply Brief, substantial record evidence exists to show that it is appropriate and reasonable to allocate primary and secondary distribution plant based on 100% demand. Yet, consistent with gradualism and basic fairness, the OCA chose to recommend a COSS that strikes the appropriate balance, is supported by the 1992 NARUC Manual, the 2000 NARUC Report, and is consistent with PPL's long-held views as to the allocation of distribution plant.

Using the OCA's recommended COSS and revenue allocation show that the RS class has achieved and indeed exceeded its cost of service in this case. As noted above, Under Mr. Watkins' COSS and proposed revenue allocation, Rate RS will pay 111% of its indexed rate of return. OCA St. 3 at 37, Table 21. It should be noted that Mr. Watkins has in fact proposed that the majority of the proposed increase ($65.8 million out of $104.6 million) be assigned to the Rate RS residential class. OCA St. 3 at 41, Table 20. But he has also demonstrated that there is no justification for PPL's proposal to allocate virtually the entire revenue increase to the residential classes. Accordingly, the OCA submits that its revenue allocation as supported by its COSS should be adopted for use to set rates in this proceeding.

a. The Scale Back Proposals.

OCA witness Watkins recommended that his revenue allocation methodology be used to allocate the rate increase, even if the amount of the increase is reduced. OCA St. 3 at 42. The mathematical effect of this recommendation is to proportionally scale back Mr. Watkins' proposed revenue allocation at the Company's full request. Id. As Mr. Watkins testified:

> I recommend that my proposed class revenue allocation be scaled-back proportionately across all classes, such that those classes with no change in revenues (GS-1 and LPEP) will clearly remain at zero with a lower overall increase and each class with a recommended increase would be scaled-back proportionately.

OCA St. 3 at 42. Several parties addressed the issue of a scale back in the event that the Commission authorizes a revenue increase that is less than the full amount requested by PPL, notably the OSBA, PPLICA, PPL, I&E and Richards Energy.

OCA witness Watkins described OSBA witness Knecht's "scale-back" proposal as follows:

> He then recommends that any reduction to this $104.6 million amount be shared in proportion to the Company's proposed distribution revenues. In other words, Mr. Knecht's scale-back recommendation is not based on the relative proportions of the Company's requested increase, but rather on the level of PPL's proposed revenues after the increase. Because Mr. Knecht's scale-back proposal is based on total distribution revenues, his recommendation produces further rate reductions (beyond those proposed by PPL) to the GS-3 class and also results in ultimate rate reductions to other commercial/industrial classes depending on the final authorized overall increase. As an illustration, Mr. Knecht provided an example of his scale-back proposal assuming an overall authorized increase of $74.6 million ($30.0 million scale-back) on page 14 of his direct testimony. As can be seen in this example, although the total jurisdictional increase is $74.6 million, Mr. Knecht's recommended scale-back would result in a residential revenue increase (RS, RTD and RTS) of $84.773 million ($80.497 + $3.276). At the same time, the GS-1, GS-3, and LP-4 classes would enjoy rate reductions of $1.793, $8.914, and $1.199 million, respectively.

OCA St. 3-R at 2-3.[20] The OSBA's scaleback methodology is not reasonable from a cost causation or fairness standpoint. The OSBA's recommendations for how to allocate any revenue increase that is less than the total amount requested by PPL were directly addressed and rejected in PPL 2010. In that case, the ALJ concluded that "a reduced amount of a rate increase does not provide a source of funding as OSBA assumes." PPL 2010, R.D. at 43. The Commission agreed with the ALJ on this issue and provided that:

> to ask one class to shoulder more of an increase than the final total increase in revenue would constitute unjust and unreasonable rates.

PPL 2010 at 46-47. Mr. Watkins succinctly described the OCA's opposition, as follows:

> As described at length in my direct testimony, I strongly disagree with PPL's cost allocation results and proposed class revenue allocations which form the starting point of Mr. Knecht's revenue allocation scale-back proposal. As a result, I conclude that Mr. Knecht's recommendation is unreasonable and should not be considered regardless of any overall revenue increase authorized in this case. However, when Mr. Knecht's scale-back mechanism is applied to more likely final outcomes of an overall jurisdictional authorized increase, it is apparent that his approach violates the majority of the recognized ratemaking principles discussed earlier in this testimony.
>
> As examples, and notwithstanding other criteria, consider the gradualism principle and a class limit of 150% of the system average percentage increase discussed by Mr. Knecht in his direct testimony under lower overall revenue requirement increases. We can see that under his scale-back mechanism, some classes would receive increases of upwards of 1,000% of the system average percentage increase, while other classes would enjoy rate reductions of several hundred percent of the system average. In my opinion, such results are well beyond any reasonable definition of gradualism and clearly are at odds with Mr. Knecht's acknowledgement of limiting class increases to 150% of the system-wide percentage increase.

OCA St. 3-R at 5-6. As discussed in Mr. Watkins' Rebuttal Testimony and the OCA's Main Brief, the OCA opposes the OSBA's proposed scale back method. See OCA St. 3-R at 1-6; see

[20] OSBA covers its scale back proposal at pages 15-16 of its Main Brief. PPLICA supports the OSBA scale back. PPLICA M.B. at 18-19.

also OCA M.B. at 101-105. PPL also opposes the OSBA scale back proposal. PPL M.B. at 156-157.

PPL states in its Main Brief that the OSBA scale back could result in customer classes who were not originally slated for an increase receiving decreases, and even classes proposed for a rate decrease seeing an even larger decrease. PPL M.B. at 156. PPL proposes that "any scaleback of revenues be applied on a proportional basis to only those rate schedules which, under the Company's original proposal, would be receiving increases." PPL M.B. at 156-157.[21]

The OCA agrees with PPL that the OSBA scale back should not be accepted in this matter, and also agrees in general principle as to how PPL's scale back would operate. The OCA does not agree, however, with PPL's proposed scale back, to the extent that it uses as a starting point PPL's initial revenue allocation proposal. The OCA submits that Mr. Watkins' revenue allocation be used as a starting point for a proportional scale back in this proceeding.

3. Tariff Structure Issues.

a. Rate Design.

The sole issue addressed by OCA in this section is PPL's proposed customer charge for the Rate RS class.

b. Customer Charge.

PPL proposes to collect virtually all of its requested increase in residential (RS) revenue from an 83% increase in the fixed monthly customer charge. The OCA opposes such a drastic change in the residential customer charge.[22] PPL's proposed customer charge is based on its flawed COSS results, would disproportionally impact low-income, low-usage customers, and

21 Richards Energy supports the PPL scale back proposal. Richards Energy M.B. at 5.

22 As Mr. Watkins testified, the OCA is not contesting PPL's proposal to keep the RTS class customer charge at its current level. OCA St. 3 at 46-47.

would reduce the incentive for customers to engage in conservation activities. Accordingly, the OCA recommends that the Rate RS customer charge continue to be set at its current level of $8.75.

I&E, OCA and the Commission on Economic Opportunity (CEO) all oppose PPL's proposal to increase its customer charge from $8.75 to $16.00. PPL M.B. at 163. PPL sets out the opposing parties' Main arguments against the increased customer charge, and submits that all such arguments should be rejected. PPL M.B. at 164. The OCA addresses these claims next.

OCA witness Watkins testified that PPL's calculations as to a correct RS customer charge are based on PPL's flawed COSS results, and its flawed minimum size study, which, as the OCA discussed above, should not be used as a guide to set rates in this matter. OCA St. 3 at 43-44. Contrary to PPL, Mr. Watkins conducted a direct customer costs analysis in accordance with the Commission's prior Orders, as he explained:

> I have conducted a direct customer cost analysis that includes only those costs required to connect a customer and Maintain a customer's account. This concept has been widely used and ordered by the Commission for many years. As an example, prior to PPL's sale of its natural gas operations to UGI, I conducted a direct customer cost analysis in Docket No. R-00061398. In that case, the Commission accepted my direct customer cost analysis and my recommended Residential customer charge.
>
> Specifically, as shown in my Schedule GAW-8, my direct customer cost analysis includes the capital costs (return, depreciation, and income taxes) associated with service lines and meters, and operating and Maintenance expenses associated with services and meters, customer installations, meter reading, customer records and collections, and other customer account expenses.

OCA St. 3 at 44. Mr. Watkins' study shows "that the direct Residential customer costs range from $7.70 per month (OCA capital costs) to $8.24 per month (PPL capital costs)." Id. As Mr. Watkins testified, a study of direct customer costs, as this Commission has endorsed in the past, shows a much lower customer charge than PPL has suggested is in order for the Rate RS class.

Moreover, PPL's proposed customer charge would distort the price signals that are necessary in order to promote efficiency and the conservation of scarce resources as Mr. Watkins explained:

> the most important and efficient tool this, or any, regulatory Commission has to promote conservation is the development of rates that send proper pricing signals to conserve and utilize resources efficiently. In this regard, a pricing structure that is largely fixed in nature such that customers' effective prices do not vary with consumption, promotes the inefficient utilization of resources. Similarly, pricing structures that are weighted heavily on fixed charges are much inferior from a conservation and efficiency standpoint than pricing structures that require consumers to incur more cost with additional consumption.

OCA St. 3 at 46. Mr. Watkins' testimony supports the OCA's arguments that PPL's use of its flawed minimum size study, and the fact that PPL did not conduct a direct customer cost analysis to calculate a customer charge for the RS class renders its proposed $16.00 customer charge unreasonable and inappropriate. Mr. Watkins' testimony also supports the fact that PPL's proposed 83% increase in the customer charge for the RS class will serve as a significant disincentive to conserve. OCA St. 3 at 46.

The OCA also presented the testimony of Roger Colton as to the impact on low-income and low-usage customers that would occur if PPL's proposed $16.00 RS customer charge was authorized. See OCA St. 4. Mr. Colton performed a thorough, in-depth study to examine the relationships between household income and electricity usage in PPL's service territory. See OCA St. 4 at 5-12. Mr. Colton found that:

> The Company's proposed increase in its monthly fixed distribution charge will adversely affect low-income, low use customers to a far greater degree than the higher-income, higher-use customers. Schedule RDC-7 provides sample monthly billing calculations at differing consumption levels at the Company's existing and proposed standard residential rates. As can be seen, customers with monthly consumption at or below 350 kWh will experience average bill increases of 40% or more under the Company's rate proposal. Customers with monthly consumption of 600 kWh will experience an average bill increase of 30%; customers with monthly consumption between 350 and 750 kWh will average bill

> increases of between 25% and 40%. Overall, for the months May 2011 through April 2012, as is shown in Schedule RDC-8, 20% of all residential bills will experience bill increases of more than 50%; 40% of all residential bills will experience bill increases of more than 40%; 50% of all residential bills will experience bill increases of more than 25%.

OCA St. 4 at 10-11 (footnote omitted). Mr. Colton found that low-use customers will experience significant disparate impacts from the Company's proposed 83% customer charge increase. As Mr. Colton further explained:

> Not only does the change in rate design place a disproportionate adverse impact on the low-income, low-use customer, but it also makes it more difficult for that customer to control his or her bill by reducing his or her consumption levels. Schedule RDC-9 presents the percentage of the total bill represented by unavoidable fixed monthly charges under the Company's proposed rate structure. Under the Company's proposed rate design, fixed monthly charges represent more than 70% of the total bill for every customer with consumption of 250 kWh or less; represent more than 60% of the total bill for every customer with consumption of 300 kWh to 400 kWh or less; and represent nearly half of the total bill for every customer with consumption of 650 kWh. All customers with monthly consumption of 1,000 kWh pay nearly 40% of their total bill in fixed charges.

OCA St. 4 at 11-12. Mr. Colton concluded that:

> The level of the Company's proposed rate increase, exacerbated by its proposed change in its rate design, will disproportionately impose adverse impacts on the customers least able to afford those bill increases. It is critical for the recommendations of OCA witness Watkins to be adopted not only for the cost reasons articulated in his testimony, but also to mitigate these harms.

OCA St. 4 at 12. Mr. Colton's testimony and thorough analysis of the customer charge issue, combined with this Commission's prior Orders on this topic as discussed by Mr. Watkins support the OCA proposal to set the RS customer charge at $8.75.

As to PPL's final argument, that economic pricing of goods in competitive markets has no relevance here – the OCA disagrees. Mr. Watkins testified on this issue, specifically in response to a comment made by PPL witness Krall in his direct testimony as to the collection of fixed costs through fixed charges is a matter of "correct economics." See OCA St. 3 at 45. In disagreeing with Mr. Krall, Mr. Watkins testified that:

> Like electric distribution companies, the cost structures for most competitive manufacturing and transportation industries are comprised largely of "fixed" costs. As is well known, the pricing structures of these competitive industries are overwhelmingly volumetric based; i.e., there are no fixed prices or charges. More directly, electricity prices have been regulated in the United States since its invention. For over a century, the collective wisdom of economists and regulators has been to price electricity largely on a volumetric basis. So that there is no confusion or argument over bundled versus unbundled electricity rates, the same is true whether generation-related costs are included or excluded in any comparison. That is, virtually every state allows variable generation fuel costs to be collected as a rider on a dollar for dollar basis. However, all fixed costs (whether bundled with generation or unbundled as distribution) are collected through base rates. It is these base rates (which are comprised Mainly of fixed costs), that have been collected for decades largely on a volumetric basis.

Id. at 45. As Mr. Watkins explained further:

> In competitive markets, consumers, by definition, have the ability to choose various suppliers of goods and services. Such is obviously not the case with the distribution portion of regulated monopoly utilities. Consumers and the market have a clear preference for volumetric pricing. Utility customers are not so fortunate in that the local distribution utility is a monopolist. The only reason utilities are able to achieve pricing structures with high fixed monthly charges is due to their monopoly status. In my opinion, this is a critical consideration in establishing utility pricing structures. That is, competitive markets and consumers in the U.S. have demanded volumetric based prices for generations: a regulated utility's pricing structure should not be allowed to counter the collective wisdom of markets and consumers.

OCA St. 3 at 45-46.

In rebuttal testimony, PPL witness Krall proposed an alternative customer charge of $14.09 for the RS class. PPL M.B. at 170-173. PPL contends that such a customer charge derivation, which includes direct and indirect costs is appropriate. Id. The OCA opposes this alternative for the same reasons as already given. Mr. Watkins' study shows "that the direct Residential customer costs range from $7.70 per month (OCA capital costs) to $8.24 per month (PPL capital costs)." OCA St. 3 at 44. PPL's inclusion of indirect costs is improper, and as Mr.

Watkins' direct customer cost analysis shows, greatly overstates the reasonable level for a RS class customer charge. Id.

Accordingly, the OCA submits that PPL's arguments in this matter should be rejected. The record evidence shows that a reasonable RS customer charge at this time is $8.75.

4. Tariff Rules And Riders.

The OCA addressed the Competitive Enhancement Rider (CER) in the Miscellaneous Issues Section, specifically in Section IX. D. below.

5. Summary and Alternatives.

For all the reasons discussed above, the OCA's COSS should be used as a guide to set rates in this matter, the OCA's revenue allocation, based on its COSS, should be accepted, the OSBA scaleback proposal should be rejected and the customer charge for the Rate RS class should remain at $8.75.

G. Miscellaneous Issues.

1. Purchase of Receivables.

In its Main Brief, the OCA commented on Direct Energy's proposals advocating certain modifications to PPL's proposed Purchase of Receivables (POR) program in this case. OCA M.B. at 111-113. Specifically, the OCA provided that PPL should only collect the incremental POR costs incurred for which it can provide support for. In no case, however, should such costs be included in base rates, and Direct Energy's POR proposals should be rejected at this time. Id.

In their respective Main Briefs, PPL, Dominion and Direct Energy address the POR issues raised in this case. After review, the OCA reaffirms its original position as to the POR issue. See OCA M.B. at 111-113.

2. CAP.

a. CAP Outreach.

In its Main Brief, PPL stated that even though it has by far the lowest Customer Assistance Program (CAP)[23] enrollment rate of any major electric utility in Pennsylvania, the Company "does not believe that it should engage in further outreach to enroll payment-troubled low-income customers into its CAP." PPL M.B. at 198. OCA witness Colton recommended that PPL implement three actions with regard to its CAP program. Specifically, Mr. Colton recommended:

> First, I recommend that the Company engage in a direct-contact outreach program aimed at a population of customers that meet *both* of two criteria: (1) the customer is a confirmed low-income customer; and (2) the customer is 120 or more days in arrears. Second, in addition to this targeted outreach, I recommend that all shutoff notices to confirmed low-income customers be modified so that they *also* contain a notice of the availability of CAP and the means of accessing CAP. Third, I recommend that the Company engage in a direct-contact outreach program focused on customers 120 or more days in arrears whether or not those customers are "confirmed" low-income customers.

OCA St. 4 at 33-34 (footnote omitted).

PPL provided the following general reasons for opposing OCA witness Colton's recommendations: (1) the Company is not required to meet a minimum CAP enrollment level; (2) it is not necessary to enroll all low-income customers in CAP because not all low-income customers are also payment troubled; (3) the Company receives telephone calls from "almost all residential customers who have received various Chapter 56 collection notices or have had their service terminated," and PPL gives these customers information regarding the availability of CAP, so there is no further need to provide additional outreach to these customers; (4) the Company receives telephone calls from an "overwhelming majority" of residential customers with overdue accounts, and PPL gives these customers information regarding the availability of

[23] PPL's CAP is called OnTrack.

CAP, so there is no further need to provide additional outreach to these customers; (5) PPL already conducts CAP outreach; and (6) PPL is concerned that a substantial increase in CAP enrollment will have a negative impact on other residential customers due to an increase in the Universal Services Charge. PPL M.B. at 198-202.

With regard to the first and second considerations above, the OCA agrees that there is not a minimum CAP enrollment level that PPL must reach and that the CAP program is geared towards low-income customers <u>that are also payment troubled</u>. <u>See</u> <u>e.g.</u> OCA St. 4-SR at 5.

With regard to the third and fourth considerations above, the OCA submits that PPL's statistics about the number of customers that contact the Company about overdue accounts and/or Chapter 56 notices is incomplete. The Company claimed that during these calls, it obtains household income information and advises eligible customers about the availability of CAP. PPL M.B. at 200-201. During hearings in this matter, however, PPL witness Dahl could not provide details on the age of the household income information in the Company's possession (*i.e.,* whether it was from a prior overdue period or the current overdue period). Tr. 563-65. As such, the OCA submits that the Company could have household income data of customers indicating that they are not income eligible for CAP from prior overdue account periods, which overdue balances customers subsequently made current. Given the current economy, it would not be uncommon for some of these customers to now have decreased household income and possibly now be income eligible for CAP. Some of these customers may have once again become behind on their balances but not called the Company, so PPL would not have the current, relevant income information and reach out to these customers regarding the availability of CAP.

With regard to the fifth consideration above that PPL already conducts CAP outreach, the OCA submits that PPL's current outreach efforts may rely too heavily on customers to initiate contact with the Company to obtain information on CAP. OCA witness Colton's recommendations were designed to supplement the Company's ongoing outreach efforts and improve the Company's ability to reach its targeted audience.

With regard to the sixth consideration above that PPL is concerned that a substantial increase in CAP enrollment could have a negative impact on other residential customers by increasing the Universal Services Charge, the OCA submits that any increase to the Universal Services Charge by increased CAP enrollment may be mitigated by a decrease in PPL's collection, termination and uncollectible accounts expense. The intention of the CAP program is for CAP customers to pay an affordable portion of their bills with residential customers paying the rest of the CAP customers' bills (the CAP shortfall) through the Universal Services Charge. An alternative to the CAP program is for these customers to pay none of their bills, have their service terminated and have PPL collect the total unpaid portions of these bills via uncollectible accounts expense.

Given the foregoing, PPL confirmed its willingness to implement OCA witness Colton's second recommendation to include information about CAP on termination notices, with some caveats. See PPL M.B. at 203. As stated in its Main Brief, the OCA would be happy to work with the Company to modify its termination notice. OCA M.B. at 119.

In its Main Brief, PPL asserted that OCA's other recommendations regarding additional CAP outreach should be rejected. PPL M.B. at 202-204. PPL asserts mostly the same reasons as the six general considerations discussed earlier in this section in support of the Company's position. Id. As discussed above, PPL's general considerations do not justify the rejection of the OCA's recommendations. As stated by OCA witness Colton:

> [PPL] seeks to continue a set of OnTrack outreach procedures that do not appear to be working. PPL has a higher percentage of confirmed low-income

> customers in debt than other electric utilities. Fewer of those PPL low-income customers in debt are on payment plans than for other electric utilities. A higher proportion of those PPL low-income customers have their service disconnected for nonpayment than for other electric utilities. Those confirmed low-income customers of PPL in debt are further in debt than confirmed low-income customers for other electric utilities. Those PPL low-income customers in debt generate a higher percentage of gross write-offs than for other electric utilities. If PPL were doing an adequate and appropriate outreach effort directed toward its low-income payment-troubled customers, given the higher relative level of payment-troubles within its confirmed low-income population, it would not have one of the lowest CAP participation rates in the state.

OCA St. 4-SR at 7-8.

The OCA submits that Mr. Colton's recommendations are appropriate and should be adopted. The Commission should direct PPL to: (1) engage in a direct-contact outreach program aimed at confirmed low-income customers with 120 or more days in arrears; (2) modify its termination notices to confirmed low-income customers to include information about the availability of Cap and means of accessing the program; and (3) engage in a direct-contact outreach program focused on all customers 120 or more days in arrears. The OCA would be happy to work with the Company in developing additional outreach initiatives.

b. <u>Application of LIHEAP Funds to CAP Customers' Accounts.</u>

In its Main Brief, PPL detailed its intentions regarding the application of Low-Income Home Energy Assistance Program (LIHEAP) funds to PPL's CAP participants' accounts. <u>See</u> PPL M.B. at 195-98. After detailing the possible outcomes for the application of LIHEAP funds to CAP customers' accounts, PPL stated that it intended to obtain direction and clarification from the Department of Public Welfare (DPW) and the Commission. PPL M.B. at 197-98. If timely guidance is not obtained, PPL stated that it intended to continue with its CAP-Plus program as it is currently implemented. <u>Id</u>. at 198.

As stated in its Main Brief, the OCA submits that the Company's proposal to obtain guidance from DPW and the Commission has merit and should be adopted. See OCA M.B. at 121. Additionally, the OCA agrees that if PPL does not obtain timely guidance prior to the start of the 2013 LIHEAP program year, that PPL's recommendation to continue with its approved CAP-Plus should be adopted. Id.

3. Consumer Education.

In its Main Brief, PPL confirmed its commitment to incorporate a program for local housing authority (LHA) administrators into its consumer education plan, as recommended by OCA witness Colton. See PPL M.B. at 195. The OCA welcomes PPL's commitment to allow its Consumer Education Plan to evolve and would be happy to work with PPL and provide comments to the Company's LHA program design.

4. Competitive Enhancement Rider/Retail Market Investigation.

The OCA submits that the Commission should accept the OCA's recommendations on the CER issue – competitive enhancement costs should not be collected from ratepayers. This position is consistent with the Commission's prior Orders and directives as to the issue of cost recovery for competitive enhancement programs, and consistent with the evidence of record in this matter. See OCA M.B. at 124-127.

Several parties addressed the CER issue in their Main Briefs. Direct Energy provided that it supports the implementation of a CER, it supports the notion that some retail market enhancement costs should be recovered from ratepayers and that the CER should apply directly to the class of customers for which retail market enhancement costs were incurred. Direct M.B. at 33. The OSBA and Richards Energy agree with directly applying certain costs to specific customer classes. OSBA M.B. at 23-24; Richards Energy M.B. at 5-6. In its Main Brief, PPL addressed the issue of direct cost assignment. PPL M.B. at 209-210.

PPL argued that costs created by consumer education benefit all customers, and as such, all customers should share in these costs. PPL M.B. at 210. The OCA agrees with PPL that all rate classes benefit from consumer education activities. While the OCA agrees with PPL that the costs should be spread among all customer classes, however, the OCA disagrees on the method to accomplish this. The OCA proposed that costs be recovered based on a per kWh basis, and not purely based on customer counts as PPL proposed. OCA St. 3 at 51-52.

PPL argues that its proposal to use customer counts as a basis for CER recovery is reasonable because "each account benefits from such programs" and "each account should bear a similar portion of the costs." PPL M.B. at 210. The OCA submits that costs should be recovered in relation to the benefits received, as Mr. Watkins testified:

> the Company proposes to structure its rider on a flat rate per customer per month. I recommend that if a rider is approved, it be structured on a class by class per KWH charge basis. Specifically, the costs associated with specific rate classes should be directly assigned to those classes. Authorized programs that are more general in nature and/or are targeted to both Residential and non-Residential customers should be allocated to classes based on number of customers. The attendant "rider revenue requirement" by class should then be collected on a per KWH basis. I note that this approach is used by at least Met-Ed, Pennsylvania Power Company and Pennsylvania Electric Company in their respective consumer education rider mechanisms.

OCA St. 3 at 51. Mr. Watkins went on to explain why it is more reasonable to recover these costs on a kWh basis, as follows:

> Consumers that use more energy clearly have much more potential to benefit from these customer education programs than consumers who use very little electricity. As such, a per KWH based rider better equates costs and benefits of these programs.

OCA St. 3 at 52. The OCA submits that Mr. Watkins proposal on this issue is reasonable and should be adopted if PPL's CER is implemented.

PPL also proposed that certain costs arising from retail market enhancement activities, such as customer referral and opt-in auction programs should be recovered from EGSs. PPL M.B. at 210. The OCA agrees with PPL that EGSs should pay for the costs of retail market enhancement activities, consistent with the Commission's recent Order and directives.[24]

The OCA further submits that any consumer education costs recovered through the CER should be limited, and subject to certain safeguards. As Mr. Watkins further testified on this issue:

> Given the Commission's directives concerning mandated consumer education plans, I have no objection to the recovery of approved specific consumer education program costs through a reconcilable rider mechanism. However, if a consumer education rider is approved, there should be at least three safeguards established.

OCA St. 3 at 49. As to the three safeguards:

1. [T]he costs allowed and included in any approved consumer education rider must conform to the standards as set forth in the Commission's May 10, 2007 Order in Docket No. M-00061957;

2. [C]ompetitive enhancements costs incurred by PPL, consistent with the Commission's directive, must be collected from EGSs; and

3. [T]here must be quantifiable assurances that there is no double recovery of these costs, such as through the CER and also included within the approved revenue requirement in this case.

OCA St. 3 at 49-50.

The OCA submits that the Commission should accept the OCA's recommendations on the CER issue – competitive enhancement costs should not be collected from ratepayers, and

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[24] See Investigation of Pennsylvania's Retail Electricity Market: Intermediate Work Plan, Docket No. I-2011-2237952, Order at 79 (March 2, 2012); see also OCA M.B. at 125.

only approved CER education costs, consistent with the Commission's Order, should be recovered on a kWh basis.

5. <u>Other Issues.</u>

The OCA has no other issues to discuss at this time.

III. CONCLUSION

For the reasons set forth in the Office of Consumer Advocate's Main Brief and this Reply Brief, the Office of Consumer Advocate respectfully submits that PPL's proposal to increase rates as set forth in Supplement No. 118 to Tariff – Electric Pa. P.U.C. No. 201 should be denied. The adjustments to PPL's proposed revenue requirement outlined and discussed in OCA's Main Brief and in this Reply Brief should be adopted. In particular, PPL's requested return on equity is excessive. A fair return on equity, as discussed in OCA's Main Brief and in this Reply Brief should be adopted. Additionally, PPL's proposed allocation of rates and rate design are not just and reasonable and should be adjusted as recommended in OCA's Main Brief and herein.

Respectfully Submitted,

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Dated: September 14, 2012

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APPENDIX A

PPL Electric Utilities Corporation
Docket No. R-2012-2290597

Table I REVISED

Income Summary

	Pro Forma Present Rates	Company Pro Forma Adjustments	Company Adjusted Present Rates	OCA Adjustments	OCA Total Recommended Revenue
Operating Revenues	$ 789,663	$ (5,201)	$ 784,462	$ -	$ 784,462
Deductions:					
O&M Expenses	354,600	62,371	416,971	(16,698)	400,273
Depreciation	130,650	9,069	139,719	-	139,719
Regulatory Debits/Credits	2,285	-	2,285	-	2,285
Other Taxes	54,568	(779)	53,789	59	53,848
Income Taxes-Federal	(42,690)	35,921	(6,769)	12,359	5,590
Income Taxes-State	-	-	1,759	3,510	5,269
Deferred Income Taxes	110,645	(81,784)	28,861	(781)	28,080
Investment Tax Credit	(1,078)	163	(915)	-	(915)
Total Deductions	$ 608,980	$ 24,961	$ 635,700	$ (1,551)	$ 634,149
Net Income Available for Return	$ 180,683	$ (30,162)	$ 148,762	$ 1,551	$ 150,313
Rate Base	$ 2,257,801	$ 164,305	$ 2,422,106	$ (9,943)	$ 2,412,163
Rate of Return Available	8.00%		6.14%		6.23%
Proposed Cost of Capital			8.46%		7.19%
Operating Income Required			$ 204,910		$ 173,435
Operating Income Deficiency (Required minus Available)			$ 56,148		$ 23,122
Revenue Conversion Factor			1.86324953		1.86680964
Proposed Rev. Requirement			$ 104,618	$ (61,454)	$ 43,164

See OCA St. 1-SR, KC-1SR, Schedule 1, Page 1

PPL Electric Utilities Corporation
Docket No. R-2012-2290597

Table II REVISED

Summary of Adjustments

Reference	Rate Base Effect	Revenue Effect	O&M/A&G Expense Effect	Depreciation Expense Effect	Income Tax Effect 41.4933% Capital Stock Tax	Net Operating Income Effect
OCA St. 1-SR at KC-1SR, Schedule 4, Page 3	$ (1,883)					$ (297)
OCA St. 1-SR at KC-1SR, Schedule 4, Page 4						
OCA St. 1-SR at KC-1SR, Schedule 2, Page 3	(10,417)					(1,640)
OCA St. 1-SR at KC-1SR, Schedule 2, Page 4	(1,020)					(161)
OCA St. 1-SR at KC-1SR, Schedule 2, Page 4	3,480					552
OCA St. 1-SR at KC-1SR, Schedule 2, Page 4	488					76
OCA St. 1-SR at KC-1SR, Schedule 2, Page 4	(1,400)					(221)
OCA St. 1-SR at KC-1SR, Schedule 2, Page 8	781					123
OCA St. 1-SR at KC-1SR, Schedule 2, Page 8						
OCA St. 1-SR at KC-1SR, Schedule 3, Page 1						(67,318)
OCA St. 1-SR at KC-1SR, Schedule 3, Page 1						10,322
OCA St. 1-SR at KC-1SR, Schedule 4, Page 3			$ (3,740)			(5,535)
OCA St. 1-SR at KC-1SR, Schedule 4, Page 4			(4,468)			(4,873)
OCA St. 1-SR at KC-1SR, Schedule 4, Page 4			(4,902)			(5,345)
OCA St. 1-SR at KC-1SR, Schedule 4, Page 5			(1,012)			(1,103)
OCA St. 1-SR at KC-1SR, Schedule 4, Page 6			(2,576)			(2,810)
OCA St. 1-SR at KC-1SR, Schedule 4, Page 2*					$ 8,940	16,666
OCA St. 1-SR at KC-1SR, Schedule 4, Page 8	-	-	-	-	59	110
	$ (9,971)	$ -	$ (16,698)	$ -	$ 8,999	$ (61,454)

fects the Interest Expense on which the Interest Synch. Adjustment is based.

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission	:	
v.	:	
PPL Electric Utilities	:	Docket No. R-2012-2290597

I hereby certify that I have this day served a true copy of the Office of Consumer Advocate's Reply Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 14th day of September 2012.

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