COMMONWEALTH OF PENNSYLVANIA
OFFICE OF SMALL BUSINESS ADVOCATE

September 14, 2012

E-FILED

Rosemary Chiavetta, Secretary
Pa. Public Utility Commission
Commonwealth Keystone Building
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta:

Enclosed for filing is the Reply Brief, on behalf of the Office of Small Business Advocate, in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please contact me.

Sincerely,

Steven C. Gray (rs)

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Acting Small Business Advocate
Attorney ID #77538

Enclosures
cc: Parties of Record
Robert D. Knecht

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Reply Brief, on behalf of the Office of Small Business Advocate, by e-filing, e-mail, and/or first-class mail (unless otherwise noted) upon the persons addressed below:

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Date: September 14, 2012

BEFORE THE
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Pennsylvania Public Utility Commission	:	
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REPLY BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

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I. **Introduction**

On March 31, 2012, PPL Electric Utilities Corporation ("PPL" or the "Company") filed with the Pennsylvania Public Utility Commission ("Commission") a request for additional annual distribution revenues of $104.6 million.

On May 24, 2012, the Commission suspended the proposed effective date of PPL's filing and instituted an investigation into the justness and reasonableness of the issues raised in the PPL filing.

On April 25, 2012, the Office of Small Business Advocate ("OSBA") filed a complaint against the PPL filing.

On May 31, 2012, a prehearing conference was held before Administrative Law Judge ("ALJ") Susan D. Colwell.

On June 1, 2012, ALJ Colwell issued her Scheduling Order.

On June 22, 2012, the OSBA served the direct testimony of Robert D. Knecht. On July 16, 2012, the OSBA served the rebuttal testimony of Mr. Knecht. On August 1, 2012, the OSBA served the surrebuttal testimony of Mr. Knecht.

Evidentiary hearings were held in Harrisburg on August 6th, 7th, and 9th, 2010.

On August 29, 2012, the OSBA submitted its Main Brief.

The OSBA submits this Reply Brief pursuant to the procedural schedule set forth in ALJ Colwell's June 1, 2012, Scheduling Order.

II. Summary of Argument

The cost of service study presented by PPL in this case provides a rational and reasonable basis for revenue allocation and rate design decisions. The costs of service study changes proposed by the Office of Consumer Advocate are not consistent with the underlying methodologies approved by the Commission in the Company's 2010 base rates case.

The revenue allocation proposed by PPL, at the full revenue request, is reasonable and should be adopted. However, if the Commission adopts the Office of Consumer Advocate's proposed changes to the minimum system cost classification methodology, the alternative revenue allocation proposed by the OSBA should be adopted.

If the Company receives less than its full revenue request, the revenue allocation proposed by PPL should not be proportionately scaled back using the traditional methodology. A proportional scale back will seriously roll back the progress towards cost-based rates that is inherent in the Company's revenue allocation proposal at the full revenue request. Rather, a reduction in the proposed increase should be shared among all rate classes in proportion to the revenues proposed for each class in this proceeding.

The Company's proposed Competitive Enhancement Rider should not be addressed in this proceeding. The Rider is better addressed in PPL's concurrent default service proceeding. However, if the Commission determines that the Rider should be addressed in this proceeding, the rate design for recovering the costs of the Rider should be changed. Costs should be directly assigned to the Company's rate classes where that is possible.

VIII. Rate Structure

A. Cost of Service Study

1. Introduction

In its Main Brief, the OSBA supported the cost of service study ("COSS") presented by PPL in this proceeding. The OSBA examined the COSS methodology employed by PPL in this proceeding and found it to be reasonable, even though the Company made certain changes to the COSS methodology. Nevertheless, those changes were such that they did not alter the OSBA's conclusion that PPL's COSS, as presented in this case, generally conforms to the COSS methodology approved by the Commission in the Company's 2010 base rates case. *See* OSBA Main Brief, at 3-9.

In its Main Brief, the Office of Consumer Advocate ("OCA") argued for a different cost of service methodology. OCA Main Brief, at 68-71. The OCA summarized its COSS methodology argument, as follows:

> The OCA presented the testimony of Glenn A. Watkins that challenged PPL's cost of service methodology, the proposed revenue allocation to the rate classes, and the proposed rate design for the residential and RTS classes. Mr. Watkins' testimony demonstrates that the Company's cost of service study inappropriately assumes that the majority of both primary and secondary distribution plant should be classified as customer related. Mr. Watkins testified, and the OCA submits, that classifying PPL's primary distribution plant costs and the majority of secondary distribution plant costs as demand related is a better reflection of cost causation principles.

OCA Main Brief, at 67 (footnote omitted).

2. The OSBA's Position on the OCA's proposed COSS Methodology

OSBA witness Robert D. Knecht summarized the OCA COSS proposals, as follows:

> As he did in the Company's 2010 base rates proceeding, [OCA witness] Mr. Watkins proposes to modify the Company's classification of certain distribution plant costs, namely poles, conductors, conduit and line transformers. Mr. Watkins proposes to make two generic modifications to the Company's 'minimum system' approach for classifying distribution plant into demand-related and customer-related components.

OSBA Statement No. 2, at 1-2. Mr. Knecht explained the first of the OCA's modifications:

> Mr. Watkins advocates certain technical changes to the Company's minimum system analysis for both primary voltage and secondary voltage plant. He argues that these changes are more consistent with the dictates of the NARUC 'Electric Utility Cost Allocation Manual.' The net impact of these changes would be to reduce the customer component of distribution plant (excluding substations, meters and services) from approximately 62 percent to approximately 42 percent. ***This change would generally reduce costs assigned to the Residential and GS-1 rate classes, and increase costs assigned to the other distribution voltage rate classes*** (including the lighting classes). The implications of this change for class rates of return in the COSS are shown in Mr. Watkins' Table 13.

Id., at 2 (emphasis added). Mr. Knecht also explained the second of the OCA's proposed modifications:

> Mr. Watkins discards his revised minimum system analysis for primary voltage plant, and argues that primary system plant should be classified as 100 percent demand-related, with a zero customer component. This change would have the effect of reducing the customer component of distribution plant (again excluding substations, meters and services) to 18 percent. The implications of these two changes for class rates of return in the COSS are shown in Mr. Watkins' Table 16.

Id.

The OSBA does not support the OCA COSS. The second modification proposed by the OCA is virtually identical to the position argued by the OCA in PPL's 2010 base rates case with respect to the classification of primary system distribution plant. Mr. Knecht explained the OSBA position regarding the OCA proposals, as follows:

> [I]n the 2010 base rates proceeding, the Company proposed to modify its method for classifying primary system plant. Prior to that proceeding, PPL Electric had classified primary system plant as 100 percent demand-related. In the 2010 proceeding, the Company proposed to adopt a customer-demand split, based on extending its minimum system analysis to the primary system as well as the secondary system.
>
> Mr. Watkins opposed that change in the 2010 proceeding, the matter was fully litigated, and the Commission approved the Company's proposal. Nothing has changed with respect to cost causation in the past two years, and the Commission's decision should be respected.

OSBA Statement No. 2, at 2.

Mr. Knecht's conclusion is undisputed. Mr. Watkins' direct testimony includes the following question and answer:

> Q. With regard to his classification of distribution plant, did Mr. Kleha utilize the same approaches and methods he used in the 2010 rate case?
>
> A. Yes.

OCA Statement No. 3, at 25.

The OSBA is well aware that precedent can be overturned for new, valid reasons. However, as Mr. Knecht points out, the Company's COSS methodology was both updated and fully litigated in PPL's 2010 base rates case. The OCA has offered nothing new in this proceeding that would provide a reason to overturn the Commission's decision in the Company's 2010 case.

B. Revenue Allocation

1. Introduction

As set forth in its Main Brief, the OSBA determined that PPL's revenue allocation proposal, at the full revenue requirement, is reasonable. *See* OSBA Main Brief, at 10-15.

As discussed above, the OCA proposed modifications to the Company's COSS. In addition, the OCA also proposed what Mr. Knecht termed "technical recommendations." OSBA Statement No. 2, at 3. The OCA summarized these changes, as follows:

> Mr. Watkins made adjustments to PPL's minimum size system calculations to recognize the 1992 NARUC Manual's prescription for circuits and circuit meters. Specifically, and in accord with the 1992 Manual, Mr. Watkins made adjustments to PPL's minimum size study as to Account No. 364 (poles), Account No. 365 (overhead conductors), Account No. 366 (underground conduit), Account No. 367 (underground conductors and Account No. 368 (line transformers). The adjustments, which did not reflect any modification to account for the load carrying capability of conductors, resulted in a substantial difference in class rates of return.

OCA Main Brief, at 89 (citation omitted).

2. The OSBA's Alternative Position on Revenue Allocation

The OSBA does not take any position on the "technical recommendations" proposed by the OCA to modify the Company's minimum system methodology. OSBA Statement No. 2, at 3.

It is possible that the Commission may accept the OCA's proposed changes the Company's minimum system methodology, but not accept any other of the OCA's modification to PPL's COSS. In the event that were to occur, the OSBA has prepared a proposed revenue allocation in light of the different results that would be produced by the Company's modified

COSS. Mr. Knecht explained how he developed the OSBA's alternative revenue allocation proposal:

> I began with my replicated version of the Company's COSS. (My version is a little different from Mr. Watkins' version, but the differences are not particularly significant.) With that electronic model, I then substituted the primary and second minimum system classification splits calculated by Mr. Watkins as shown in his Tables 10, 11 and 12. I then confirmed that the class rates of return in my simulation were reasonably similar to those in Mr. Watkins' Table 13.
>
> As shown in Mr. Watkins' Table 13, this alternative version of the COSS indicates that all classes except the GS-1, GS-3 and LP-5 classes are producing a return that is below system average. That table also shows that the largest impact of this alternative COSS relative to the Company's COSS is on the GS-3 and LP-4 customer classes, which see their class rates of return at present rates fall from 17.5 percent to 11.5 percent and 10.0 percent to 4.7 percent respectively.

OSBA Statement No. 2, at 3 (footnote omitted).

Mr. Knecht then set forth the alternative revenue allocation, as follows:

> The Company's proposed rate increase for residential RTS customers should remain as proposed, for the reasons detailed in my direct testimony. Even with this possible change to the COSS, the RTS class rate of return at proposed rates would increase only to 0.3 percent, far below the system average of 8.5 percent. If traditional gradualism principles are applied to this rate class, it will likely be many years before the cross-subsidies are reduced to an acceptable level.
>
> Average rate increases for the LP-4 and GH-2 classes should be set at 1.5 times the system average increase, to reflect the principle of rate gradualism (and to be consistent with Mr. Watkins' recommendations in that respect).
>
> The increase for the lighting classes should be set at system average.
>
> The Company's proposals for the LP-5 and LPEP classes should be retained.

> The Company's proposed rate decrease for Rate GS-3 should be retained, and the Company's small proposed increase for GS-1 customers should be eliminated.
>
> The increase for the residential RS class should be modestly reduced below that proposed by the Company, to roughly 1.4 times system average. This increase would leave the RS class with a rate of return modestly below system average, but would result in rates being much more in line with allocated costs.

OSBA Statement No. 2, at 4.

The table set forth below summaries this alternative revenue allocation proposal. The table illustrates that substantial progress is made toward moving rates close to allocated costs if the OCA minimum system methodology is adopted by the Commission.

Alternative Revenue Allocation Proposal Based on OCA Minimum System Proposal					
	Class RoR Present Rates	**Class RoR Proposed Rates**		**Revenue Allocation ($000)**	**Percent Increase**
RS	4.9%	8.1%		$ 94,239	19.9%
RTS	-4.8%	0.3%		$ 3,568	77.8%
GS-1	9.1%	9.1%		$ 0	0.0%
GS-3	11.5%	10.8%		($ 4,674)	-3.8%
LP-4	4.7%	7.3%		$ 7,206	21.4%
LP-5	-5.6%	8.3%		$ 712	59.1%
LPEP	21.9%	21.9%		$ 0	0.0%
GH-2	3.7%	6.4%		$ 296	21.4%
SL/AL	5.9%	8.4%		$ 3,269	14.3%
Total	**6.1%**	**8.5%**		**$104,616**	**14.3%**

OSBA Statement No. 2, at 5, Table IEc-R1.

3. Scale Back

As set forth in the OSBA's Main Brief, it is likely that the ALJ and the Commission will not approve the entirety of the Company's $104.6 million distribution revenue request. Consequently, some type of scale back methodology must be used to allocate the revenue increase among PPL's customer classes. The OSBA respectfully submits that it should be a goal of this proceeding to maintain the progress toward cost-based rates that was an integral part of the Company's original revenue allocation proposal. OSBA Main Brief, at 15-16.

In its Main Brief, the OCA argued that the OSBA scale back proposed "is not reasonable from a cost causation standpoint." OCA Main Brief, at 104. However, as Mr. Knecht pointed out, there are three undisputed facts in this proceeding:

> Small business customers have been subsidizing other customer classes for decades;
>
> The Commonwealth Court explicitly determined in the 2004 PPL Electric base rate proceeding that cost of service was the 'polestar' rate design criterion;
>
> That PPL Electric committed to moving rates into line with allocated costs within three base rate proceedings, and that was four base rate proceedings back.

OSBA Statement No. 3, at 8.

The entire point of the OSBA's scale back methodology is that it maintains the progress towards cost-based rates present in the Company's original revenue allocation proposal. The OSBA proposal would allow all customers to benefit from a scale back, not just a select few.

Furthermore, even the Company recognizes the fairness of the OSBA scale back proposal. PPL stated:

> The Company believes that OSBA's proposed scale back, while not achieving system average returns in all rate schedules, does continue to move rate classes towards the system average return.

> The Company acknowledges that movement toward the system average return is an important objective and has made certain proposals in its direct case in this proceeding toward that end.

PPL Main Brief, at 156. However, the Company continued, as follows:

> However, the Company also believes it is important to consider the expectations of customers who may not be experts in revenue allocation and rate design principles. The Company believes it will be difficult for customers, especially residential customers, to accept a scale back that gives reductions to customers who were not, in the first instance, expecting an increase or, in the extreme, gives greater reductions to certain customers than were originally proposed.

Id.

The OSBA has little sympathy for this line of reasoning. PPL's small business customers have been subsidizing other rate classes for decades. The *Lloyd* decision was supposed to bring relief to those beleaguered customer classes[1]. PPL promised that in three rates cases, revenues for all classes would be brought into line with cost of service. Instead, GS-3 customers continue to overpay, and by a substantial amount.

The Commission should simply apply the principles of the *Lloyd* decision and scale back the revenue allocation so that all classes benefit in this proceeding, and the small business customers of PPL receive the relief which they have been denied for so many years.

In contrast to the OSBA proposal, the Bureau of Investigation & Enforcement ("I&E") argued for a different scale back methodology. Mr. Knecht summarized the I&E proposal, as follows:

> [I&E witness] Mr. Hubert's proposal is a modified version of the proportional scaleback, in which first dollar relief is provided to

[1] *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010 (Pa. Cmwlth. 2006), *appeals denied,* 916 A.2d 1104 (Pa. 2007).

> the RTS class, and a proportional scaleback is applied to the RS, LP-5, GH-2 and SL/AL rate classes. (Mr. Hubert excludes the small GS-1 and LP-4 rate increases from his proposed scaleback.)

OSBA Statement No. 3, at 5-6.

The table below sets forth the OSBA and I&E scale back proposals using the "differential rate of return" metric. The differential rate of return is simply the difference between the rate of return for an individual class and the system average rate of return. *Id.*, at 6. It is simple to use, and does not mislead the reader as the much-maligned "indexed rate of return" metric.

Alternative Scaleback Proposals Differential Rate of Return				
	Present Rate Differential RoR	**PPL Proposed Rates Full Rev. Requirement**	**Hubert Scaleback**	**RDK Scaleback**
RS/RTD	-2.3%	-1.4%	-2.0%	-1.3%
RTS	-10.2%	-6.5%	-12.6%	-6.1%
GS-1	2.1%	-0.1%	2.1%	0.1%
GS-3	11.4%	8.2%	10.4%	7.8%
LP-4	3.9%	1.6%	3.7%	1.8%
LP-5	-11.7%	0.3%	-10.2%	-2.3%
LPEP	15.5%	13.2%	15.2%	12.1%
GH-2	-0.8%	0.3%	-0.6%	0.3%
Lighting	0.0%	0.0%	0.1%	-0.3%
Total	**0.0%**	**0.0%**	**0.0%**	**0.0%**

OSBA Statement No. 3, at 6, Table IEc-S1.

In regard to the I&E scale back proposal, Mr. Knecht observed:

> Mr. Hubert's scaleback proposal badly fails at maintaining the progress toward cost-based rates that was inherent in the Company's revenue allocation proposal for almost all rate classes. For example, under present rates, the GS-3 class was providing a rate of return that was 11.4 percentage points higher than system

> average, and the Company's proposal would reduce that to 8.2 percentage points. With Mr. Hubert's proposal, much of that progress is lost, with the GS-3 class ending up with a class rate of return still a full 10.4 percentage points above system average. Similarly, much of the substantial progress toward cost-based rates for the RS, RTS, GS-1, LP-4, and GH-2 rate classes that is inherent in the Company's proposal is also lost in Mr. Hubert's scaleback.

OSBA Statement No. 3, at 6-7.

The OSBA respectfully requests that the ALJ and the Commission reject the I&E scale back proposal. The lack of progress towards cost of service inherent in the I&E proposal is a fatal flaw that is unacceptable in PPL's fourth base rates case since the *Lloyd* decision was issued.

IX. <u>Miscellaneous Issues</u>

A. Purchase of Receivables

In its Main Brief, Direct Energy Services, LLC ("Direct Energy") recommended that a non-bypassable charge, applicable to all of PPL's distribution customers, should be implemented in order to recover the Company's uncollectible accounts expense. Direct Energy Main Brief, at 16-22. The key rationale for this proposal offered by Direct Energy is that the current mechanism fails to reflect the differences in uncollectibles rates between shopping and non-shopping customers. Direct Energy Statement No. 1, at 10.

Mr. Knecht explained the Company's current recovery mechanism, as follows:

> PPL Electric recovers uncollectibles costs associated with electricity supply in two ways.
>
> For non-shopping customers, PPL Electric includes a 'Merchant Function Charge' in its GSC and TSC rates, which is imposed as a percentage of the cost of providing default service. That percentage is differentiated by class, and is set based on the historical uncollectibles rate.

> For shopping customers who take service from an EGS that uses the PoR program, PPL Electric applies a percentage discount to the price at which it purchases the receivables, to reflect the uncollectibles cost. That percentage is the same one used in establishing the MFC, again differentiated by rate class.
>
> Finally, for customers who take generation service from an EGS who does not use the PoR program, PPL Electric does not incur any supply-related uncollectibles costs, and it therefore does not impose any supply-related uncollectibles charges. In this last case, the uncollectibles cost is borne by the EGS.

OSBA Statement No. 2, at 10 (formatting added).

Mr. Knecht stated three reasons that the OSBA does not support the Direct Energy proposal. Mr. Knecht stated the first reason:

> [B]ecause customers can freely switch back and forth from shopping to non-shopping status, it makes little sense to establish separate uncollectibles charges for the two groups of customers. If there is, say, a 1 percent chance that a customer will not pay its PPL Electric bill when taking default service PPL Electric, it is reasonable to assume that there is a 1 percent chance that the customer will not pay its PPL Electric bill when taking EGS service.

OSBA Statement No. 2, at 11.

Mr. Knecht continued:

> Mr. Cernigia's recommendation would in no way correct this alleged 'problem.' Mr. Cerniglia's proposal would continue to impose the same uncollectibles charge on shopping and non-shopping customers. It would simply pretend that the uncollectibles charge is not related to electricity supply.

Id.

Finally, Mr. Knecht observed:

> [I]f there are any customers who take service from EGSs who do not use the PoR program, Mr. Cerniglia's proposal would result in these customers being double-charged for uncollectibles; first by

> PPL Electric and second by their own EGS which also must recover its own uncollectibles costs in its rates.

Id.

Consequently, the OSBA does not support Direct Energy's proposal for a non-bypassable uncollectibles charge. Direct Energy's proposal does not appear to correct any of the inequities of which Direct Energy complains, and is so broadly designed that it introduces new rate issues for various PPL customers.

D. CER

As discussed in the OSBA's Main Brief, the Company has proposed the adoption of a Competitive Enhancement Rider ("CER") in this proceeding. *See* PPL Statement No. 8, at 30-32. In general, the OSBA recommended that this issue be deferred to the Company's concurrent default service proceeding. In the alternative, if the Commission decides that a CER should be implemented in this proceeding, the OSBA recommended that costs be direct assigned, where possible. *See* OSBA Main Brief, at 22-24.

In its Main Brief, PPL argued that the OSBA recommendation to directly assign costs is unnecessary. PPL stated:

> [C]ertain costs, especially those arising from the Retail Markets Investigation, relate to programs for which only specific rate classes are eligible. Such costs might be more appropriately directly assigned to specific rate classes. Such costs include the customer referral mailing, standard offer referral program and retail opt-in auction. In all of these instances, however, PPL Electric has proposed that costs be recovered from participating EGSs. Therefore, these costs that could be directly assigned to specific classes may not be recovered through the CER at all.

PPL Main Brief, at 210.

PPL may have *proposed* that such directly assignable costs be recovered from participating EGSs. It is, therefore, possible that these costs *may* not be recovered by the CER mechanism. However, all that is true if things fall out the way that PPL proposes.

It is much more reasonable to directly assign costs, where possible, so that the cost-causing customer class pays. By designing the CER in this way, each class will pay its fair share of the costs to the extent possible, rather than waiting to see whether PPL's proposal is ultimately accepted. Moreover, the OSBA sees no down side to requiring PPL Electric to incorporate the flexibility to set different CER charges by rate class. Even if that flexibility goes unneeded, it certainly does no harm.

X. Conclusion

Wherefore, as set forth in the OBSA's Main Brief and this Reply Brief, the OSBA requests that the ALJ and the Commission:

1. Adopt the PPL cost of service study as the basis for the revenue allocation and rate design decisions in this proceeding;

2. Adopt the PPL revenue allocation at the full revenue requirement of $104.6 million;

   a. In the alternative, if the ALJ and the Commission adopt the OCA's minimum system changes, adopt the OSBA's alternative revenue allocation;

3. Scale back the revenue allocation in proportion to the proposed class revenues if a revenue requirement of less than $104.6 million is approved;

4. Adopt PPL's proposed rate design changes for the GS-1, GH-1, and GH-2 customer classes;

5. Adopt PPL's proposed rate design changes for the GS-3 customer class, but require PPL to identify and contact any single-phase service GS-3 customer that would benefit from switching to the GS-1 customer class;

6. Order that PPL's proposed Competitive Enhancement Rider should not be addressed in this proceeding, but rather in PPL's concurrent default service proceeding;

   a. In the alternative, change the Rider's rate design to allow for separate charges by rate class and by requiring PPL Electric to directly assign costs to the Company's rate classes where that is possible.

Respectfully submitted,

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