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File #: 150736

November 8, 2012

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

RE: Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation
<u>Docket No. R-2012-2290597</u>

Dear Secretary Chiavetta:

Enclosed for electronic filing are the Exceptions of PPL Electric Utilities Corporation for the above-referenced proceeding.

Copies have been provided to the persons in the manner indicated on the certificate of service.

Respectfully Submitted,

John H. Isom

JHI/jl
Enclosure
cc: Certificate of Service
Honorable Susan D. Colwell

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing **Exceptions** have been served upon the following persons, in the manner indicated, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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Date: November 8, 2012

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXCEPTIONS OF
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Date: November 8, 2012

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I. INTRODUCTION

The Recommended Decision ("RD"), for the most part, sets forth a reasonable and appropriate resolution of the many issues raised in this proceeding and, in large part, should be adopted by the Pennsylvania Public Utility Commission ("PUC" or the "Commission"). There are, however, five significant areas where Commission intervention and revision are required in order to establish just and reasonable rates. These are: (1) the cost of common equity; (2) storm damage expense; (3) consumer education; (4) use of historic averages to set prospective rates; and (5) payment for services provided by affiliates. Several additional issues also should be reviewed carefully, but they are of somewhat less significance and importance.

Cost Of Common Equity. The RD's proposed 9.74% return on common equity (9.68% plus 0.06% for good management) is seriously inadequate and is at odds with many prior Commission decisions and decisions of other regulatory commissions across the country. The principal error in the RD is its sole reliance on an unadjusted discounted cash flow ("DCF") methodology. This Commission has repeatedly rejected this approach in prior cases, including PPL Electric Utilities Corporation's ("PPL Electric") last fully litigated rate proceeding, and has consistently either: (1) adopted a leverage adjustment, or (2) relied on other methodologies as inputs in determining the return on common equity. Adjusting the RD's base cost of common equity (9.68%) for a leverage adjustment (0.70%) and PPL Electric's proposed adjustment for good management (0.12%) produces a cost of common equity of 10.5%. This result is: (1) consistent with, but slightly below, the results produced by other methods, *i.e.*, 10.75% for the risk premium method and 10.58% for the CAPM method; (2) well within the range of recent Commission decisions (10.1% to 11.0%); and (3) well within the central tendency (10.0% to 10.74%) of recent decisions by other regulatory commissions.

The cost of common equity decision in this case is being closely watched by other Pennsylvania utilities and the investment community. The result adopted in this proceeding will be directly relevant to the Commission's upcoming determination of the cost of common equity to be used in the Distribution System Improvement Charge ("DSIC") mechanism recently authorized in Act 11 for electric and gas industries. It is important that the Commission provide an appropriate signal to the industry and the investment community that the Commission is supportive of the DSIC and the massive infrastructure investments required by Pennsylvania utilities to continue to provide safe and reliable service to customers. A return allowance of 10.5% or higher will send such a signal; the RD's 9.74% recommendation will not.

Storm Damage Expense. The RD approved PPL Electric's proposed claim for storm damage expense, including the premium for storm damage insurance. However, the RD also concludes that the storm insurance program has not benefitted customers and recommends that the insurance not be renewed and that PPL Electric be directed to file a reserve/tracker mechanism within 90 after a final Commission decision in this proceeding. The RD's conclusions regarding storm damage insurance are in error and should be rejected. However, as a result of Hurricane Sandy, the worst storm in the history of PPL Electric, it is now apparent that PPL Electric will not be able to obtain storm damage insurance on reasonable terms after its current policy expires on December 31, 2012. The issue of retaining storm damage insurance therefore is moot. As a result, PPL Electric proposes that the Commission adopt PPL Electric's revised storm damage expense. Specifically, the revised expense claimed by PPL Electric should be approved as a reasonable estimate of ongoing normal storm damage expense, and PPL Electric should be directed to file a proposed storm damage reserve/tracker mechanism with the Commission as soon as possible after a final order is entered in this proceeding.

Consumer Education Programs. The RD concludes that PPL Electric's existing Commission-approved Consumer Education Plan is duplicative of education measures contained in its Act 129 Energy Efficiency and Conservation ("EE&C") program and the Commission's Retail Markets Investigation ("RMI") proceeding, and therefore should be disallowed. The record evidence demonstrates that these programs are complementary and not duplicative of other programs, and PPL Electric believes these important programs should be continued. If the Commission agrees, PPL Electric will continue these programs. If not, these programs will be discontinued.

Use Of Historic Averages To Set Prospective Rates. In several instances, the RD reduces PPL Electric's future test year expense claims because they exceed various historic averages. Ratemaking is prospective, and rates should be set to reflect anticipated conditions during the future test year and the initial period new rates will be in effect. Historic averages are useful in determining the reasonableness of an expense claim, but should not be used where there are changed circumstances which demonstrate that the historic average does not produce a reasonable result. In three instances, i.e., uncollectible accounts expense, environmental management expense, and external affairs expense, PPL Electric has demonstrated that historic averages do not reasonably reflect future conditions. In each instance, PPL Electric's claimed expense should be approved.

Payment For Services Provided By Affiliates. PPL Electric pays its affiliates 20 days after receipt of invoice. The RD, however, proposes that PPL Electric's cash working capital requirement be calculated based on a hypothetical assumption that PPL Electric pay its affiliated suppliers in 60 days, rather than 20 days. This adjustment should be rejected because: (1) it is not consistent with actual practice and (2) 20 days is a commercially reasonable payment term which is typical of payment terms to non-affiliated vendors. There is no reasonable basis to treat affiliated vendors different from non-affiliated vendors.

For these reasons and as more fully set forth below, PPL Electric's Exceptions should be granted and the RD revised accordingly.

II. EXCEPTIONS

Exception No. 1: The RD's Proposed 9.74% Cost Of Common Equity Is Far Too Low And Should Be Increased To At Least 10.5%. RD, pp. 50-94.

PPL Electric excepts to the RD's conclusion that the Company's cost rate for common equity is 9.74%. The principal error in the RD is its sole reliance on an unadjusted DCF cost rate. The Commission has concluded on numerous occasions, including PPL Electric's last fully litigated rate proceeding, that use of only one method to determine the cost of common equity without a check on the reasonableness of the result of that method is not appropriate.

The record evidence in this proceeding establishes that the unadjusted DCF cost rate recommended in the RD significantly understates the cost of equity. For example, the Risk Premium analysis presented by Company witness Moul indicates a 10.75% cost rate - - more than 100 basis points above the RD's recommended cost rate, which reflects 9.68% DCF cost rate plus 6 basis points for management performance. Similarly, even if the 120 basis point size adjustment is removed from PPL Electric's CAPM analysis, the CAPM analysis indicates a cost of equity of 10.58%.

In prior cases where the DCF model produced an under estimation of the cost rate of common equity, the Commission has employed a leverage adjustment as an addition to the unadjusted DCF results. The RD recognized this fact, stating as follows: "The Commission has applied the leverage adjustment in cases where it believes market conditions have resulted in a DCF cost rate that is understated." RD at 70. In this case, the leverage adjustment increases the

DCF result by 70 basis points from 9.68% to 10.38%, before addition of any increment for management performance. When PPL Electric's 12 basis points adjustment for management performance is added to the adjusted DCF cost rate of 10.38%, the allowed return on equity should be 10.5%. In other instances, the Commission has given weight to the results of other cost rate models and selected an equity cost rate within the range of those results. The RD's failure to apply either approach results in an understated cost rate that is inconsistent with long-standing Commission practice and precedent.

The RD's only check on the reasonableness of the unadjusted DCF cost rate was a recent decision in a PEPCO case cited in OCA's briefs. However, as explained further in these exceptions, there were circumstances in the PEPCO case, including poor service, that caused the Maryland Public Service Commission to lower the ROE for PEPCO. Further, the record in this case demonstrates that the ROE allowance in PEPCO is well below the reasonable range of ROEs allowed by other commissions since 2008 (10.0% to 10.74%) and is not likely to be viewed as constructive by capital markets as PPL Electric and other Pennsylvania utilities seek to raise capital to fund expanded infrastructure replacement programs encouraged by Act 11 of 2012 ("Act 11").

The determination of the equity cost rate in this proceeding is important not only for PPL Electric, but for the utility industry in Pennsylvania. In 2013, the Commission will be implementing the provisions of Act 11, which provides mechanisms to support and encourage enhanced investments in infrastructure in Pennsylvania. Markets are watching the actions of the Commission, and the allowed cost of common equity in this proceeding will be viewed as an indicator of the return on common equity which the Commission will use in calculating the DSIC under Act 11. In this regard, Regulatory Research Associates ("RRA") currently ranks the

Commission at the bottom of the middle range of Commissions in terms of supportiveness to capital markets. PPL Electric St. 12-R, pp. 4-5. The implementation of the provisions of Act 11 creates the opportunity to improve this rating, but that opportunity can be realized only if the Commission adopts an ROE for use in the DSIC mechanism that meets investors' expectations of the cost of equity and is deemed to be supportive of investments to be made in Pennsylvania.

For the reasons summarized here and explained in these Exceptions, the Commission should reject the 9.74% recommendation and adopt a cost of equity for PPL Electric that is based on either a DCF analysis adjusted for leverage or that also reflects the results of the Risk Premium analysis or properly calculated CAPM analysis. Doing so will result in a cost rate that is within the range of the ROEs allowed in jurisdictions that are deemed to be supportive of capital investment.

a. The Commission Should Not Place Sole Reliance On An Unadjusted DCF Analysis In Arriving At The Cost Of Equity.

The RD arrives at the DCF result by adding I&E's dividend yield of 4.89% to the growth rate in earnings projected by analysts reported by I&E of 4.79%, producing a DCF cost rate of 9.68%.[1] RD, p. 66-68. The RD then added .06% for management performance to arrive at the recommended equity cost rate of 9.74%. RD, pp. 84-89.[2]

The principal problem with the 9.74% recommendation is the use of an unadjusted DCF result without any check on its validity. The RD simply rejects the results of other cost rate

[1] The RD correctly rejected I&E witness Sears recalculation of analysts projected growth rates through Ms. Sears' "log linear" analysis because there is no basis to conclude that investors use such an approach. RD, pp. 67-68; PPL Electric MB, p. 124; PPL Electric RB, p. 59.

[2] PPL Electric's evidence effectively supports the 9.68% unadjusted DCF analysis based upon a dividend yield of 4.67% and a growth rate of 5.0%, yielding a 9.67% unadjusted DCF result. PPL Electric MB, p. 104; PPL Electric St. 11, p. 4.

models based on alleged flaws in the models without recognition of the flaws of the DCF model.[3]

With regard to the Risk Premium method, the RD rejects the method and cites only the contention of I&E witness Sears that of the equity premium component of this model is derived from historic experience "which may not be applicable for the future." RD, pp. 77-78. This argument is contrary to the evidence and circumstances of this case.

The Risk Premium method has particular applicability in this case because it reflects the prospective A-rated public utility bond yield under current market conditions. Therefore, it

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[3] Most states use multiple methods either to arrive at the cost of equity or as a check on the DCF result. Commissions in 33 states have used other methodologies in conjunction with the DCF in setting the return on equity. *See Golden Heart Utilities, Inc. and College Utilities Corp.*, 2008 Alas. PUC LEXIS 133 (2008); *UNS Electric, Inc.*, 2010 Ariz. PUC LEXIS 358 (2010); *Application of California Water Service Co.*, 2009 Cal. PUC LEXIS 233 (2009); *Application of the Southern Connecticut Gas Co.*, 2009 Conn. PUC LEXIS 134 (2009); *Potomac Electric Power Co.*, 2010 D.C. PUC LEXIS 68 (2010); *Delmarva Power and Light Co.*, 2009 Del. PSC LEXIS 185 (2009); *In re: Water and Wasterwater Industry*, 2008 Fla. PUC Lexis 667 (2008); *Atmos Energy Co.*, 2008 Ga. PUC LEXIS 157 (2008); *Hawaiian Electric Co., Inc.*, 2008 Haw. PUC LEXIS 222 (2008); Pacficorp DBA Rocky Mountain Power, 2011 Ida. PUC LEXIS 40 (2011); *Northwest Natural Gas Co.*, 1995 Ill. PUC Lexis 25 (1999); *Indiana - American Water Co., Inc.*, 2010 Ind. PUC Lexis 155 (2010); *Re Interstate Power Co.*, 152 PUR4th 377 (1994); *In the Matter of the Application of Kansas City Power & Light Co.*, 2010 Kan. PUC LEXIS 1132 (2010); *In the Matter of Application of Kentucky-American Water Co.*, 2010 Ky. PUC LEXIS 1479 (2010); *In the matter of the application of Consumers Energy Co.*, 2012 Mich. PSC LEXIS 156 (2012); *In the Matter of Aquila, Inc. d/b/a Aquila Networks*, 2007 Neb. PUC LEXIS 332 (2007); *Application of Sierra Pacific Power Co.*, 2006 Nev. PUC LEXIS 92 (2006); *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc.*, 2011 N.Y. PUC LEXIS 275 (2011); *In the Matter of General Proceeding to Determine Permanent Pricing for Unbundled Network Elements*, 2003 N.C. PUC LEXIS 1502 (2003); *In the Matter of the Review of SBC's Ohio's TELRIC Costs for Unbundled Network Elements*, 2004 Ohio PUC LEXIS 505 (2004); *In the Matter of the Application of Oklahoma Gas and Electric Co.*, 2005 Okla. PUC LEXIS 266 (2005); *Northwest Natural Gas Co.*, 1999 Ore. PUC LEXIS 61 (1999); *In Re: Application of United Utility Cos., Inc.*, 2010 S.C. PUC LEXIS 144 (2010); *In Re: Petition of Chattanooga Gas Co.*, 2010 Tenn. PUC LEXIS 224 (2010); *Application of TXU Electric Co.*, 2001 Tex. PUC LEXIS 68 (2001); *In the Matter of the Application of Rocky Mountain Power*, 2010 Utah PUC LEXIS 50 (2010); *Tariff filing of Green Mountain Power Corp.*, 2006 Vt. PUC LEXIS 237 (2006); Application of Virginia Natural Gas, Inc.; 1998 Va. PUC LEXIS 271 (1998); *WA. Utilities and Transportation Comm. V. Puget Sound Energy, Inc.*, 2012 Wash. UTC LEXIS 423 (2012); *Bluefield Gas Co.*, 2012 W. Va. PUC LEXIS 123 (2012); *Review of Financial Data, Rates, and Tariffs Filed by the Wisconsin Gas Co.*, 1989 Wisc. PUC LEXIS 6 (1989); *In the Matter of the Application of Pacificorp*, 2004 Wyo. PUC LEXIS 72 (2004).

In addition, Commissions in seven states including Pennsylvania have used other methodologies as a check on the reasonableness of the DCF calculation. *See In the Matter of the Application of Entergy Arkansas, Inc.*, 2007 Ark. PUC LEXIS 239 (2007); *Black Hills/Colorado Electric Utility Co., LP*, 2011 Colo. PUC LEXIS 1285 (2011); *Bangor Hydro-Electric Co.*, 1999 Me. PUC LEXIS 403 (1999); *In the Matter of Union Electric Co., d/b/a Ameren Missouri*, 2011 Mo. PSC LEXIS 954 (2011); *Application of Minnesota Energy Resources Corp.*, 2009 Minn PUC Lexis 5 (2009); *Energy North Natural Gas, Inc., D/B/A National Grid NH*, 2009 N.H. PUC LEXIS 114 (2009); *Pa. PUC v. City of Lancaster*, 2011 Pa. PUC LEXIS 1685 (2011).

reflects interest rates to be experienced by public utilities during the period rates will be in effect. In this regard, using an A-rated bond yield produces an equity cost rate below PPL Electric's cost rate because PPL Electric is rated Baa2, indicating a higher cost of debt and equity. PPL Electric St. 10-R, p. 4.

Turning to the RD's acceptance of I&E's contention that average historic market premiums "may not be applicable for the future," it is to be noted that OCA's witnesses admitted that risk premiums tend to **increase** during periods of lower interest rates. Tr. at 329-30. Accordingly, it is likely that the lower interest rates currently being experienced indicate that the average historic premium **understates** the premium expected by investors for the future. Again, this makes the Risk Premium analysis in this case conservatively low under current market conditions. For these reasons, the 10.75% Risk Premium provides a clear demonstration of the inadequacy of the unadjusted DCF analysis.[4]

In Philadelphia Suburban Water Company, the Commission placed reliance on Risk Premium analysis where it believed the DCF result understated the cost of equity:

> We shall adopt the ALJ's DCF derived cost of common equity of 12.05% because we are persuaded that the growth factor adopted by the ALJ is well within the zone of reasonableness supported by the record evidence. **For all their infirmities, the parties' risk premium results are persuasive that the cost of common equity is higher than the DCF derived result. DCF results have seemed to be on the low side for some time.** In addition, we are persuaded that due to the Company's capitalization ratios, it faces a higher financial risk than the barometer group of companies. In addition, the evidence indicates a need for capital investment to improve and upgrade its plant. We concur with the OCA that the correlation between the cost of equity and financial risk cannot be precisely quantified. **The use of informed judgment, however is a *sine qua non* of ratemaking in general and setting the cost of capital in particular. It is attendant upon an evaluation of the unique facts presented in each**

[4] The RD also cites I&E's contention that the historic risk premium is overstated because it reflects data only through 2007. RD, p. 90. However, it is to be noted that the actual historic premium is 6.23% and was reduced to 5.50% in Mr. Moul's risk premium analysis. PPL Electric RB, p. 73. It also is to be noted that utility bond ratings have declined significantly since 2000, indicating higher risk for both debt and equity investors. PPL Electric St. 12-R, p. 6 and Ex. JMC-2.

> **proceeding. In this regard, the parties' analyses resulted in a range in the cost of equity of between 12.0 to 14.5%. Due to the evidence that derived DCF results may not fully reflect current capital costs as well as persuasive evidence that PSWC's increased leverage may increase its financial risk vis-à-vis the barometer group of companies, we are persuaded that a range of reasonableness in the cost of equity is 13.0 to 14.0 and that a 13.7% cost of equity is appropriate in this proceeding.**

Emphasis supplied. *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, Docket Nos. R-870840 *et al.*, 96 P.U.R. 4th 158, 207, 1988 Pa. PUC LEXIS 433 at *135 - *137, Order entered July 26, 1988; See also, *Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, Docket No. R-891218 et al., 109 P.U.R. 4th 250, 272, 1989 Pa. PUC LEXIS 225 at *52, Order entered December 29, 1989.

The RD also declined to use the results of the CAPM analysis as a check on the ROE recommendation. The RD summarizes the CAPM analyses by the Company, OCA and I&E and simply accepts OCA's and I&E's contention that there are "shortcomings" in the model. RD, p. 80. I&E's CAPM cost rates of 8.68% and OCA's CAPM cost rate of 8.14% were properly rejected for the reasons explained in PPL Electric's briefs. PPL Electric RB, pp. 60, 63-64. However, PPL Electric's CAPM presentation should not be similarly dismissed.

PPL Electric's CAPM cost rate for the electric delivery group is 11.78%. PPL Electric St. 11, p. 55. However, the RD notes PPL Electric's 120 basis point size ("business risk") adjustment should be rejected.[5] RD, pp. 92-93. Removing the 120 basis point size adjustment from the CAPM analysis would reduce the CAPM result to 10.58%. The RD did not provide any basis for rejecting a revised CAPM excluding the size adjustment.

The RD itself notes that the Commission has concluded that it is necessary to use other methods as a check on the results of the DCF, citing the Commission decision in PPL Electric's 2004 rate case:

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[5] The RD implies that the 120 basis points is a general business risk adjustment. That is incorrect. It was applied only in the CAPM analysis. PPL Electric St. No. 11, pp. 54-55.

> As noted previously, we have primarily relied upon the DCF methodology in arriving at our determination of the proper cost of common equity. The ALJ interpreted our previous actions in *PA WC* and *Aqua* as not compelling the use of other methods such as RP and CAPM to form an equity return based on a composite of the DCF and other methods. We agree with the ALJ insofar as these prior actions do not compel the use of methods in addition to the DCF method. However we conclude that methods other than the DCF can be used as a check upon the reasonableness of the DCF derived equity return calculation. We note that all of the parties in this proceeding with the exception of the OTS have done so. We will also use the results of the CAPM and RP methods as a check on the reasonableness of our DCF calculation.
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> Those returns indicated by alternative, standard cost-estimation techniques provide additional measures so as to test the reasonableness of our DCF based cost of equity capital rate of 10.70% (10.25 + .45 for financial risk). The PPL CAPM study produces a 10.70% return rate for its Electric Company Proxy Group. A USDOD CAPM study estimates an appropriate equity return of 11.00% [*103] The USDOD risk premium result is 10.44%. The OCA estimates a CAPM rate range of 9.0 to 10.0%. Additionally, a Risk Premium analysis that indicates an appropriate return on equity for its electric proxy group of 11.75%.

RD, pp. 77-78. Based on this decision, the RD's sole reliance on a DCF analysis with no leverage adjustment should not be adopted.

It also is to be noted that the 10.7% DCF cost of equity for PPL Electric referred to in the above quote included a 45 basis points leverage adjustment. The Commission then compared that result to other methods, including Risk Premium. Finally, the criticism of the Risk Premium analysis which the RD accepted in PPL Electric's current case also would have been "applicable" in the 2004 rate case. Nevertheless, the Commission looked at multiple analyses to determine whether a DCF result <u>adjusted</u> for leverage was reasonable. Here, the RD fails to follow the Commission precedent by either adding the leverage adjustment to the unadjusted DCF result or relying on other methods, such as the risk premium.

The Commission's review of the results of multiple methods recognizes that no method is without flaws and limitations. The record evidence in this proceeding demonstrates that the DCF contains many assumptions and flaws. PPL Electric St. No. 11, pp. 24-25, 35-37; PPL Electric St. 11, Appendix E, pp. E-7 to E-12. In this regard, the DCF result is controlled by each witness' selection of an investor expected growth rate. While analysts' projections can be used as an independent source of growth rate data, those projections contain some circularity because they are affected by ROEs allowed by regulatory commissions. PPL Electric St. No. 11, pp. 24-25.

The RD provides no justifiable basis for not using the results of Risk Premium and CAPM analyses as performed by Company witness Moul as a check on the result of a DCF analysis without a leverage adjustment. The results of these alternative models demonstrate that the unadjusted DCF result of 9.68% recommended in the RD must be adjusted by the leverage adjustment to produce an ROE that is consistent with results of other methods (risk premium = 10.75%; CAPM less size adjustment = 10.58%). Adjusting the 9.68% cost of equity by 70 basis points for the leverage adjustment produces a 10.38% cost of equity, prior to any addition for management performance.

b. PPL Electric's Proposed Leverage Adjustment Should be Approved.

The RD notes that the Commission has employed a leverage adjustment as an addition to the unadjusted DCF result, noting that there is precedent for the adjustment. RD, p. 69. The RD also notes that the Commission has applied the leverage adjustment where it believes the unadjusted DCF cost rate understates the cost of equity. RD, p. 70. However, the RD rejected all other methods of determining the cost of equity and thereby effectively precludes any meaningful check on the DCF result and any possibility of upward adjustment.

The RD cites a number of alleged criticisms of the leverage adjustment offered by I&E and OCA. It is to be noted that all of those criticisms have been advanced previously in cases where the Commission adopted a leverage adjustment. Importantly, the Commission's use of the leverage adjustment has been affirmed by the Commonwealth Court as within the Commission's discretion, noting the basis for the adjustment. In a 2004 case involving Pennsylvania American Water Company ("PAWC"), the Commonwealth Court rejected OCA's challenge to the Commission's use of the leverage adjustment, holding as follows:

> As to economic theory, the PUC explains the reasons the common equity costs rate adjustment is appropriate. First, the formula used to estimate cost rate is market based, but Utility's stock is not publicly traded and is listed at a much lower book value. Under these circumstances the formula can understate the cost of capital.
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> Similarly, Utility highlights the testimony of its expert, who opined that "the capital structure ratios measured at the utility's book value show more financial leverage, and hence higher risk, than the capitalization measured at its market values." R.R. at 987a.
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> The present issue involves the application of a market value cost to a book value amount of common stock. The PUC made its adjustment to the common equity cost rate in recognition of the "financial risk" arising from the different valuation methods.
>
> No witness stated that 0.6% was an appropriate adjustment. However, as Utility's expert opined that an adjustment of about 0.8% was appropriate, the record supports an adjustment larger than that approved. Further, case law supports an adjustment. E.g., West Penn Power Co. Also, the amount of the adjustment is exactly the same in this case as in the last rate proceeding involving Utility. R.R. at 900a. That prior order was not appealed. Under these circumstances, there was [**19] no abuse of discretion in making the identical adjustment.

Popowsky v. Pa. P.U.C., 868 A.2d 606, 612-13 ("*PaAmerican*"). (Footnote omitted).

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

Corp., (Dec. 22, 2004), Docket No. R-00049255, 45 basis point adjustment; *Pa. P.U.C. v. PPL Gas Utilities Corp.*, (Feb. 8, 2007), Docket No. R-00061398, 70 basis points.

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

> Based upon our analysis and review of the record, the Recommended Decision, and the Exceptions and Replies thereto, we reject the ALJ's recommendation to add a 65 basis point risk adjustment. The award of such an adjustment is not precedential but discretionary with the Commission. In fact, in *Met Ed/Penelec* (*Pa. P.U.C. v. Metropolitan Edison Co./Pennsylvania Electric Co.* Order of Jan. 11, 2007, at R-000161366 and R-00061367), we specifically approved the removal of any risk adders from the cost of equity calculations. *Met Ed/Penelec* at 136.
>
> In the cases cited by Aqua in support of its leverage adjustment, it is obvious that the DCF results in those cases were not as high as the unadjusted DCF result we have in this proceeding, since the final cost of equity in those cases was no higher than 10.6% with the leverage adjustment. The unadjusted DCF results presented by the Parties in this case are generally higher than the DCF recommendations from the earlier cases cited by Aqua. When viewed in the context of the other methodologies, we conclude that there is no need to have an upwards adjustment to compensate for any perceived risk related to Aqua's market-to-book ratio. Accordingly, we reject the ALJ's recommendation to allow a 65 basis point leverage adjustment.

Id., pp. 38-39, (*Aqua 2008*).

In *Aqua 2008*, the Commission determined that the cost of equity was 11.0% as applied to a 50.9% common equity ratio. There, the Commission noted that the DCF cost of equity in cases where it had used a leverage adjustment was no higher than 10.6%, including the leverage adjustment. In this case, the DCF cost of equity is 10.38%, including a 70 basis point leverage adjustment, which is well within the range where the leverage adjustment has been employed.[6]

[6] Parties to this proceeding also state that the Commission declined to adopt a leverage adjustment in the City of Lancaster's (Water) 2011 base rate proceeding. *See Pa. P.U.C. v. City of Lancaster Bureau of Water,* Docket Nos. R-2010-2179103, et al. (July 14, 2011). It is important to note that the City of Lancaster decision does not stand for the proposition that the Commission has forever shut the door on adopting a leverage adjustment. Rather, the Commission simply exercised its discretion in that proceeding not to adopt a leverage adjustment, citing the Aqua

The RD appears to conclude that OCA's and I&E's criticisms of the leverage adjustment are a basis to reject the adjustment, despite the fact that it has been accepted on numerous occasions in the past and each of these criticisms have been offered in the past. RD, pp. 73-76.

The principal criticism offered by OCA and I&E is that there is no risk difference between a capital structure where equity is valued at market as compared to book prices, because the amount of interest that must be paid on debt remains the same. The error of this argument is that the interest amounts are greater as a percentage of book equity capitalization than they are as a percentage of market equity capitalization. Therefore, the risk of debt payments is less as a percentage of market equity capitalization than it is at book equity capitalization. Because the DCF sets the equity cost rate at market capitalization, it understates the investor cost rate when applied to the rate base. PPL Electric St. No. 11, pp. 38-39; PPL Electric St. 11-R, pp. 29-30. Further, the fact that the OCA's and I&E's fundamental argument has been presented to and rejected by the Commission is made clear by the Commonwealth Court's affirmance of the use of leverage adjustment in OCA's appeal from PAWC 2004 case. The Court stated as follows:

> As to economic theory, the PUC explains the reasons the common equity costs rate adjustment is appropriate. First, the formula used to estimate cost rate is market based, but Utility's stock is not publicly traded and is listed at a much lower book value. Under these circumstances the formula can understate the cost of capital.

Pa. American, p. 12.

OCA also repeated its argument advanced in previous cases that the leverage adjustment is improper because market prices in excess of book value for utility stocks indicate that utilities have earned more than their cost of capital. The Commission has rejected this fundamental proposition many times noting that controlling market prices of utility stocks is not the province

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2008 case that it was unnecessary to adopt the leverage adjustment in that proceeding. *Id.*, p. 79. This is consistent with the Commission's actions in other proceedings where it has reviewed the entire record and either chose to of the Commission. *Pa. P.U.C. v. Blue Mountain Consolidated Water Co.*, Docket No. R-78100686, 55 Pa. PUC 502, 1982 Pa. PUC LEXIS 160 *2, *11, (Order entered January 14, 1982); *Pa. P.U.C. v. The York Water Co.*, Docket No. R-850268 *et al.*, 62 Pa. PUC 459 1986 Pa. PUC LEXIS 26, *103, n. 24, (Order entered November 25, 1986).[7] The evidence in this proceeding demonstrates that stocks have traded above book value for extended periods of time indicating that erroneous acceptance of OCA's contention would mean that all corporations earn returns in excess of their cost of capital. PPL Electric St. 11, p. 39. In fact, OCA's witness's recommendation in this proceeding is designed to reduce utility stock prices to book value without regard to the negative effect that this would have on the ability to raise capital in a market where stocks generally sell at prices in excess of book value. PPL Electric IB, p. 128.

The RD also notes I&E's contention that the leverage adjustment had been advanced in Pennsylvania 68 times and accepted only 6 times. RD, p. 72. However, the evidence of record establishes that most of the 68 cases were settled and certainly cannot be construed to have rejected an adjustment being approved in many litigated proceedings. Tr. 235.

The other contention offered by OCA, that the leverage adjustment is effectively a fair value rate base or market to book adjustment, is not supported by financial literature, has been refuted in the record, and has been previously rejected by the Commission. PPL Electric St. 11-R, pp. 26-28; PPL Electric IB, pp. 128-29.

It is to be noted that OCA argued in its brief, citing numerous cases, that this Commission has placed primary reliance on the DCF in arriving at the cost of equity. OCA MB, pp. 51-52.

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adopt or chose not to adopt a leverage adjustment based upon the specific circumstances of each case.

[7] For these reasons, the Commission rejected a market to book adjustment in the *Blue Mountain* case, but that case did not involve the leverage adjustment, which is not a market to book adjustment. Further, the Commission has adopted the leverage adjustment numerous times since the *Blue Mountain* case. PPL Electric St. 11-, pp. 31-32.

As noted in the Company's Reply Brief, in each of the cases, the Commission added a leverage adjustment in arriving at its DCF cost of equity. These cases are as follows:

> *Pa. P.U.C. v. Pennsylvania American Water Company*, Docket No. R-00038304, 99 Pa. P.U.C. 38, 2004 Pa. PUC LEXIS 29 (Jan. 16, 2004) ("*PAWC 2004*"), *aff'd*, *Popowsky v. Pa. P.U.C.*, 868 A.2d 606 (Pa. Cmwlth. 2004); *Pa. P.U.C. v. Aqua Pa., Inc.*, 99 Pa. P.U.C. 204, 233 (2004) ("*Aqua 2004*"), and *Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-00049255, 237 P.U.R. 4th 419, 2004 Pa. LEXIS 40 (Dec. 22, 2004) ("*PPL 2004*"). However, OCA fails to note that in each of these cases the Commission employed a leverage adjustment to the DCF analysis because the unadjusted DCF results were deemed inadequate by the Commission. The Commission added a 60 basis point leverage adjustment in *PAWC 2004*, a 60 basis point leverage adjustment in *Aqua 2004* and a 45 basis leverage adjustment in *PPL 2004*. Therefore, in the cases OCA cites where the Commission decided to rely primarily on DCF, the Commission also used a leverage adjustment. Furthermore, OCA appealed the use of the leverage adjustment by the Commission in *PAWC 2004*, and the Commission's action was affirmed by the Commonwealth Court. *Popowsky v. Pa. P.U.C.*, 868 A.2d 606, 612-13. *See* PPL Electric IB, pp. 106-07.

Under the previously explained circumstances of other reliable methods indicating higher cost rates than the unadjusted DCF analysis, the RD erred in declining to include a leverage adjustment when relying solely on the DCF analysis to arrive at the recommended cost of equity.

c. The RD's Reliance On The Maryland PEPCO Decision To Justify An ROE Less Than 10% Is Unjustified.

The RD notes the ROE determination in a decision in Maryland involving PEPCO as quoted in OCA's Main Brief. RD, p. 62. The RD relies on the PEPCO ROE determination, and other unspecified cases cited in OCA's Main Brief that were addressed on the record as support for the 9.74% recommendation. The Maryland Commission determined that PEPCO would be allowed a 9.31% ROE.

Unfortunately, neither the RD nor the OCA cite a further quote from the PEPCO decision provided in the Company's Reply Brief, which explains that the ROE that was allowed to PEPCO reflected poor service quality and the effects of a revenue decoupling mechanism employed by PEPCO.

> [W]e find that Pepco's ROE should reflect the substandard reliability and service quality of Pepco's distribution system, as our recent decision in Case No. 9240 emphasizes. The Company must be held accountable, and cannot provide poor service and expect that its return on equity and overall rate of return will be unaffected, let alone increased. In a competitive market, for which regulation is intended to be a substitute, Pepco's continuing poor reliability would cause it to lose business and profits to its competitors. We cannot and will not allow Pepco, a monopoly distribution company, to reap growing profits while it provides subpar service to its customers.
>
> As a result of these considerations, we conclude that Pepco's appropriate ROE should be near the middle of the stated range. Our chosen ROE of 9.25% includes a 50 basis point reduction for the risk-stabilizing effect of the BSA, which continues to effectively levelize Pepco's income stream, thus reducing Pepco's risk. Without the BSA, Pepco would see more dramatic swings in its earnings than currently. The BSA adjustment and the ROE are linked, and lowering Pepco's risk through the BSA also reduces the need to lower Pepco's risk through a higher ROE. We further add a 6 basis point upward adjustment for flotation costs, based on the reasoning of Mr. Campbell, and consistent with our prior decisions in recent Pepco and Delmarva base rate cases. The final ROE of 9.31% recognizes the less risky nature of Pepco's operations, is based on a wide and varied range of methodologies, and balances the interests of Pepco's ratepayers and shareholders.

In RE PEPCO, Order No. 85028, 2012 Md. PSC LEXIS 41 at *188 (Md. PSC, July 20, 2012).

Therefore, the 9.31% ROE adopted by the Maryland PSC clearly has been reduced to reflect "substandard reliability" and to reflect the effects of the Bill Stabilization Adjustment ("BSA"), which is a revenue stabilization mechanism authorized for PEPCO in its 2007 rate case. *In the Matter of the Application of Potomac Electric Power Co. for Authority to Revise its Rates and Charges fro Electric Service and for Certain Rate Design Changes*, Order No. 81517, 2007 Md. PSC LEXIS 13 (Md. PSC, July 19, 2007). Neither of those circumstances apply to PPL Electric and, therefore, the 9.31% ROE does not demonstrate the reasonableness of the RD's recommended allowance for PPL Electric.

OCA also cites cases with ROE allowances in the range of 9.25% to 9.8% in its brief. OCA Main Brief, p. 48. PPL Electric notes that a number of other Commissions have approved significantly higher ROE allowances in the range of 10.25% to 10.5% since the beginning of

2012. PPL Electric RB, pp. 66-67.[8] The RD makes no reference to these recent cases with higher ROE allowances cited by PPL Electric. The RD does note that the range of most ROE allowances presented by PPL Electric witness Cannell's report of all ROE allowances in the country since the beginning of 2009 was between 9.75% and 10.99%. RD, p. 56. Nevertheless, the RD adopts a cost of equity at the very bottom of this range. This analysis clearly demonstrates that there are far more ROE allowances in excess of 10.0% than below and that both the central tendency and most of these allowances fall between 10.0% and 10.74%. PPL Electric St. 12-R, p. 4, Sch. JMC-1 (attached as Appendix A to these Exceptions).

Ms. Cannell, a utility financial analyst for 20 years, explained the importance of the ROE allowance to investors' perception of the regulatory environment in each jurisdiction:

> This data suggests that neither I&E's nor OCA's ROE recommendations would meet investor expectations for the Company. Moreover, an authorized return at or near the levels proposed [by I&E and OCA] would put the Company at a distinct disadvantage in the competition for capital going forward. Adopting either the I&E or OCA proposal also would represent a step backward by the Commission in establishing a constructive, consistent regulatory framework for Pennsylvania. It bears mention that Regulatory Research Associates continues to maintain the "Average/3" ranking of Pennsylvania regulation it has had in place since late 1998. The undue reliance on low interest rates by these witnesses produces unrealistic equity return rates that do not reflect the requirement that utilities must raise capital in all markets. Dramatic changes in allowed ROEs like those proposed in this case by Ms. Sears and Mr. Hill ignore the fact that investments in utility assets is a long term proposition.

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[8] *See In the Matter of the Application of Consumers Energy Co. for Authority to Increase its Rates for the Generation and Distribution of Electricity and for Other Relief*, Case No. U-16794, 2012 Mich. PSC LEXIS 156 at *118 (Mi. PSC, June 7, 2012) (Commission approved an ROE of 10.3%); *In the Matter of the Application of Northern States Power Co. d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in Minnesota*, Docket No. E-002/GR-10-971, 2012 Minn. PUC LEXIS 132 at *19 (Mn. PUC, May 14, 2012) (Commission approved an ROE of 10.37%); *In re: Petition for Increase in Rates by Gulf Power Co.*, Docket No. 110138-EI, 2012 Fla. PUC LEXIS 233 at *138 (Fl. PSC, April 3, 2012) (Commission approved an ROE of 10.25%); *In the Matter of Application of Duke Energy Carolinas, LLC, for Adjustment of Rates and Charges Applicable to Electric Utility Service in North Carolina*, Docket No. E-7, SUB 989, 2012 N.C. PUC LEXIS 103 at *74 (NC UC, January 27, 2012) (Commission approved an ROE of 10.5%); *Application of Duke Energy Carolinas, LLC for Authority to Adjust and Increase its Electric Rates and Charges*, Docket No. 2011-271-E, 2012 S.C. PUC LEXIS 14 at *30 (SC PSC, February 3, 2012) (Commission approved an ROE of 10.5%); *Application of Wisconsin Power and Light Co. for Authority to Adjust Electric and Natural Gas Rates*, Docket No. 6680-UR-118, 2012 Wisc. PUC LEXIS 257 at *11 (Wi. PSC, July 19, 2012) (Commission approved an ROE of 10.4%).

PPL Electric St. 12-R, pp. 4-5.

The adoption of Act 11 creates the potential to improve the view of supportiveness of Pennsylvania regulation in capital markets. However, adopting an ROE that is an outlier to ROEs adopted both by the majority of other jurisdictions and particularly by those viewed by capital markets as supportive is likely to thwart the chance of such improvement and possibly even be viewed as negatively affecting the perceived regulatory environment in Pennsylvania.

Finally, PPL Electric notes that the ROE should reflect prospective conditions. While past ROE allowances provide perspective, they are adopted under economic conditions that were difficult. Relying too much on the past when the economy is improving, albeit slowly, risks under estimating the cost of equity capital that PPL Electric will face as it seeks to raise capital to fund its expanded infrastructure improvement program during the period that rates set in this proceeding will be in effect.[9]

d. The Commission Should Approve The Management Performance Adjustment Proposed By PPL Electric.

PPL Electric requested a 12 basis point (0.12%) increment to the ROE to reflect exemplary management performance. The RD correctly summarized PPL Electric's evidence of management performance. RD, pp. 85-88; PPL Electric IB, pp. 115-20; RB, pp. 73-75.

The RD proposes a 6 basis point increment for management performance relying on certain criticisms of PPL Electric, principally situations where the Company agreed to negotiated payments to resolve certain alleged violations of the Public Utility Code or Commission regulations. As explained in PPL Electric's briefs, these limited circumstances do not provide a basis for denying the requested adjustment to the cost of equity.

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[9] PPL Electric explained the significance of its expanded infrastructure program of the ROE in this proceeding in its Initial Brief, pp. 84-89.

e. Conclusion

For all the foregoing reasons, the Commission should conclude that the RD's reliance on an unadjusted DCF analysis results in an inadequate ROE. The Commission should adopt a cost of equity/ROE that includes a leverage adjustment in the DCF analysis, gives consideration to the Risk Premium and CAPM analyses, and reflects a determination that is in the main stream cost of equity recommendations that are viewed by capital markets as supportive of future investment to replace aging infrastructure.

Exception No. 2: Storm Damage Costs Should Be Recovered Through A Reserve/Reconcilable Rider Mechanism Because Storm Damage Insurance Will No Longer Be Available As A Result of Hurricane Sandy. RD, pp. 34-40.

PPL Electric's original claim for storm damage expense in this proceeding had three components: (1) an annual budget amount for expected storm damage not covered by current insurance ($12,625,000 which is composed of two pieces – $3.175 million for non-reportable storms which are not covered by insurance and $9.45 million for that portion of the insurance deductible allocated to expense), (2) a budgeted amount for the storm damage insurance premium ($8.75 million), and (3) a proposed 5-year amortization for extraordinary losses incurred in 2011, in excess of insurance coverage ($5.324 million per year). PPL Electric St. 2-RJ, pp. 3-6; PPL Electric Exs. GLB-9 and GLB-10; PPL Electric IB, p. 48; RD, p. 34. Thus, the total storm damage expense in this proceeding is $26,699,000.

This ratemaking treatment of storm damage expenses was first approved by the PUC in PPL Electric's 2007 rate case as part of a settlement. *Pa. P.U.C. v. PPL Electric*, Docket No. R-00072155, p. 8 (Dec. 6, 2007), and was approved again in PPL Electric's 2010 rate case as part of another settlement. *Pa. P.U.C. v. PPL Electric,* Docket No. R-2010-2161694, p. 9 (Dec. 21, 2010).

The RD recommended approval of all of above components of PPL Electric's storm damage expense. However, the RD also recommended that the storm damage insurance be terminated prospectively and replaced by an I&E proposal for a reserve account and storm tracker when the present insurance coverage expires. RD, p. 39. As explained below, PPL Electric strongly disagrees with the RD's analysis regarding the continuation of storm damage insurance. However, due to the Hurricane Sandy, which struck PPL Electric's service territory on October 29, 2012, storm damage insurance and reinsurance similar to the policies presently in effect will not be available after December 31, 2012, when present coverage expires.[10] Thus, the issue of whether the storm insurance program should continue has become moot. As a result, PPL Electric proposes the following: (1) that the Commission approve a normal expense claim of $17,875,000 plus $5,324,000 for an amortization of the extraordinary losses in 2011 and (2) that PPL Electric will file for a storm damage automatic adjustment clause as soon as practicable after the Commission's final order in this proceeding.

By way of background, PPL Electric first purchased storm damage insurance in 2007. Since its inception, the insurance has been underwritten by PPL Power Insurance, Ltd. ("PPL Insurance"), an affiliated Bermuda corporation. A portion of the insurance underwritten by PPL Insurance has been reinsured by unaffiliated insurers. PPL Electric St. 14-R, p. 3. The insurance covers storm damage caused by Commission-reportable storms (I&E Ex. 2-SR, Sch. 2, p. 10), which are storms that interrupt service to at least 2,500 customers for at least six consecutive hours. 52 Pa. Code § 67.1(b). Insurance coverage is subject to a deductible that has varied from

[10] PPL Electric asks that the Commission take official notice of Hurricane Sandy and damage caused by it pursuant to 52 Pa. Code § 5.408. Of course, the record contains no evidence of Hurricane Sandy because it struck PPL Electric's service territory commencing on October 29, 2012, after the record was closed. It is appropriate, however, to bring the consequences of Hurricane Sandy, specifically the termination of the storm damage insurance program, to the Commission's attention so that it will not waste resources deciding whether the storm damage insurance program should be continued because the issue is now moot.

year to year and to a maximum limit of liability that also has varied from year to year. The Commission approved these practices in settlements. *Pa. P.U.C. v. PPL Electric*, Docket No. R-00072155, p. 8 (Dec. 6, 2007), and was approved again in PPL Electric's 2010 rate case as part of another settlement. *Pa. P.U.C. v. PPL Electric,* Docket No. R-2010-2161694, p. 9 (Dec. 21, 2010).

The RD's recommendation that storm damage insurance should not be renewed, is based on the conclusion that it has not been used to benefit ratepayers. This conclusion appears to be based primarily on time value of money associated with the delay between the incurrence of storm damage losses and the payment for these losses. RD, p. 37. PPL Electric fully explained the reasons for this delay. PPL Electric IB, p. 60; PPL Electric RB, pp. 25-27. More importantly, however, it is undisputed that any cost associated with the delay between the incurrence of losses and the payment of claims is not reflected in rates and therefore has no adverse impact on customers and provides no basis for a conclusion that the storm damage insurance program has not benefited customers. PPL Electric St. 7-R, pp. 7-8.

In any event, the issue of whether PPL Electric should renew its storm damage insurance has become moot as a result of Hurricane Sandy, which struck PPL Electric's service territory on October 29, 2012. This storm is the worst storm in the history of PPL Electric in terms of the number of customers whose service was interrupted and one of the most expensive in terms of the cost of repairs and service restoration. PPL Electric's preliminary estimates indicate that service to more than 440,000 customers was interrupted by Hurricane Sandy and that costs from the storm will exceed $60 million.[11]

[11] PPL Electric anticipates that it will file a petition with the Commission for permission to defer and amortize losses from Hurricane Sandy in excess of insurance coverage similar to the petitions that it filed related to Hurricane Irene and the Halloween snowstorm in 2011.

Even prior to Sandy, the continued availability of storm insurance has been precarious. PPL Electric explained on the record that:

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

PPL Electric St. 14-RJ, pp. 12-13. As a result of Hurricane Sandy, PPL Insurance will again be called upon to pay to PPL Electric the entire policy limit for storm damage for 2012. As a result, PPL Insurance will not have sufficient statutory capital and surplus to prudently continue to provide storm damage insurance to PPL Electric. That is, PPL Insurance has informed PPL Electric that it will not offer storm damage insurance to PPL Electric for 2013. PPL Electric also has been informed that reinsurance will not be available on terms and conditions similar to the reinsurance policy presently in effect.

For these reasons, the question of whether storm damage insurance should be renewed has become moot, and the RD's recommendation that PPL Electric file for a reserve/tracker mechanism with reconciliation for over and under collections should be approved. PPL Electric intends to propose such a mechanism in a filing to be made as soon after the Commission decision in this proceeding as practicable. PPL Electric will request that the proposal be give expedited consideration so that it can become effective at the earliest possible date.

A reserve/tracker mechanism for storm damage expense is clearly appropriate. The Commission and the appellate courts have explained the circumstances in which an automatic adjustment clause is appropriate. Clauses are appropriate when the expenses to be recovered through the clause are substantial, subject to variation and beyond the control of the utility. *See,* *e.g., Popowsky v. Pa. P.U.C.*, 869 A.2d 1144, 1159 (Pa. Cmwlth. 2005) *appeal denied*, 586 Pa. 761, 895 A.2d 552 (2006); *Pennsylvania Industrial Energy Coalition v. Pa. P.U.C.*, 653 A.2d 1336 (Pa. Cmwlth. 1995); *Pa. P.U.C. v. Newtown Artesian Water Co.*, Docket Nos. R-2009-2117550, *et al.*, 2010 Pa. PUC LEXIS 757 (Apr. 15, 2010); *Pa. P.U.C. v. Philadelphia Thermal Energy Corp.*, Docket No. R-911920, 1991 Pa. PUC LEXIS 80 (May 3, 1991). Here, there can be no question that the incurrence of storm damage expenses is beyond PPL Electric's control, that such expenses can be substantial and that such expenses can vary considerably from year-to-year. In 2011, storm damage losses approached $100 million for year; in other years, expenses have not reached the insurance deductible. PPL Electric St. 14-R, p. 5. Approval of an automatic adjustment clause for storm damage expense, therefore, is clearly appropriate.

In addition, because PPL Electric's original claim for storm damage expense included a claim for the insurance premium and because insurance will no longer be available after December 31, 2012, it is necessary to revise PPL Electric's storm damage expense claim. The revised expense claim has the following three components which total $26.699 million

The first component is for the budgeted amount of $12.625 million for storm damage not covered by insurance. This component consists of two parts: (1) smaller, non-PUC reportable storms which are not covered by insurance ($3.175 million) and $9.45 million for losses from PUC-reportable storms that PPL Electric has had to pay to reach the storm damage insurance deductible. This $12.625 million amount was approved at page 35 of the RD.

The second component is for the normal ongoing level of storm damage that was previously covered by insurance but will not be covered once the existing insurance policy expires on December 31, 2012. This amount should be set at $5.25 million, which is the portion of the insurance premium allocable to operating expense. Specifically, the total insurance premium included in the budget was $8.75 million, and approximately 60% of storm damage expense is charged to operating expense and 40% is charged to capital. The operating expense portion of the insurance premium ($5.25 million (8.75 million x 60%)) provides a reasonable measure of ongoing storm damage which will be charged to operating expense. Determining the level of storm damage expense based on the insurance premium is appropriate even though the insurance will not be renewed because the premium was calculated by an independent actuary to equal average covered losses over time. PPL Electric St. 14-R, p. 3. Thus, the total storm damage expense for "normal" storm insurance expenses should be $17.875 million ($12.625 million + $5.25 million).

This claim for "normal" storm damage expense of $17.875 million is supported by historic levels of normal storm damage costs charged to expense. During the four years ended December 31, 2011, PPL Electric incurred the following total distribution storm costs charged to expense, excluding extraordinary amounts deferred for amortization.

2008	2009	2010	2011	Total
$19,600,000	$6,600,000	$11,900,000	$31,200,000[12]	$69,300,000[13]

The average expense over this period, excluding losses deferred for amortization, is $17,325,000 ($69,300,000 ÷ 4), which demonstrates the reasonableness of the Company's $17.875 million revised claim.

The third component is the amortization for extraordinary storm damage losses in excess of insurance coverage during 2011 for Hurricane Irene and the Halloween snowstorm. These deferred losses total $26,622,000. PPL Electric Ex. GLB-10; RD, pp. 40-41. The five-year

[12] This amount has been adjusted to remove the $26,622,000 of extraordinary storm costs for 2011 that have been deferred for amortization.
[13] I&E Ex. 2, Sch. 25, p. 2.

amortization produces an annual expense of $5.324 million. The RD also approved this amount at 40.

Based on the foregoing, PPL Electric proposes a total storm damage expense of $23.199 million, including $17.875 million for normal storm losses and $5.324 million for amortization of extraordinary losses in excess of insurance coverage in 2011.

Exception No. 3: The RD's Proposed Disallowance of PPL Electric's Commission-Approved Consumer Education Plan Expense, Which Would Promote Competition and Conservation, Should Be Rejected. RD, pp. 46-49.

The RD would disallow completely recovery of costs associated with PPL Electric's Commission-approved Consumer Education Plan, which promotes and encourages the competitive retail market for electric generation in PPL Electric's service territory and encouraging conservation, beyond 2012. The issue presented here is whether the Commission recognizes the need for the Energy Education Standards it established in its Final Order on *Policies to Mitigate Potential Electricity Price Increases* at Docket No. M-00061957 and wants the Consumer Education Plan to continue, it should approve PPL Electric's claim of $5,482,220 for that Plan, in addition to other consumer education expenses. If not, the RD should be adopted on this issue, and PPL Electric will discontinue the program.

The RD would permit recovery of certain consumer education expenses, including (1) expenses to comply with Commission mandates in the RMI through PPL Electric's proposed Competitive Enhancement Rider ("CER") and (2) costs to implement PPL Electric's Commission-approved Energy Efficiency and Conservation (EE&C) Plan through PPL Electric's existing Act 129 Rider. RD 46-49. However, the RD would disallow Consumer Education Plan expenses based on the conclusion that the Consumer Education Plan duplicates programs whose costs are to be recovered under the Act 129 Rider and the proposed CER. RD, pp. 49. The record demonstrates otherwise. PPL Electric's proposed Consumer Education Plan meets the

Commission's Education Standards and complements, and does not duplicate, programs and expenses under the RMI and Act 129.

PPL Electric's Consumer Education Program arises from the Commission's Final Order in *Policies to Mitigate Potential Electricity Price Increases*, Docket No. M-00061957. Pursuant to that order, PPL Electric initiated a broad-based program of consumer education to assist consumers in understanding how they can shop for electric energy in Pennsylvania's competitive retail electricity supply market and how they can use electricity more efficiently. The goal of this Program was and is to educate consumers so that they will use energy wisely and understand how to reduce their bills. The Program is based on the premise that, given appropriate information and education, consumers can exercise more control over their electric bills by using electric energy wisely and by shopping for the best price, thereby controlling their electric bills. PPL Electric's program has targeted all customers including low-income households. PPL Electric St. 6, p. 4. PPL Electric's proposal in this proceeding is to continue to provide consumers with fundamental information on the wise and efficient use of energy, as well as the purchasing electric energy.

Contrary to I&E's contention, PPL Electric's Consumer Education Plan does not duplicate efforts and expenses under the Energy Efficiency and Conservation Plan ("EE&C Plan") under Act 129. Instead, it is a separate and distinct plan with separate and distinct goals. The Consumer Education Plan educates consumers regarding shopping for electricity, the importance of energy efficiency and conservation and the steps they can take to control their electric bills. PPL Electric St. 6-R, p. 3. The Act 129 EE&C Plan, in contrast, provides financial incentives, such as rebates, for consumers to take approved actions such as installing energy efficient lighting, HVAC systems and EnergyStar appliances in order to meet Act 129 consumption reduction targets. PPL Electric's Consumer Education Plan and the Act 129 EE&C Plan are complementary, but their functions are separate. The Consumer Education Plan is purely educational; the Act 129 EE&C Plan is purely financial. PPL Electric St. 6-R, pp. 3-4.

Nor does the Consumer Education Plan duplicate actions taken to comply with the Commission's orders in the RMI, Docket No. I-2011-2237952 (July 28, 2011). There, the Commission established an intermediate work plan and recognized the importance of consumer education to support the retail electricity market. The RMI *Order* mandated activities separate from the Consumer Education Plan. Activities under the RMI were mandated initially by a Secretarial Letter which directed EDCs, including PPL Electric, to print in accordance with the Commission's design and specifications and mail to customers a postcard encouraging customers to visit the PaPowerSwitch.com website and to consider shopping for a competitive electricity supply. The Secretarial Letter also required two additional mailings during 2012.

It is important to emphasize also that the Commission will have continuing oversight of PPL Electric's Consumer Education Plan in 2013 and beyond. All programs and activities associated with the Plan are submitted to the Commission's Office of Communication and the OCA for review. The submittals are provided with a description of the program or activity along with proposed spending levels, implementation time frames and target audiences. In addition, PPL Electric will continue to tie each educational program to the eight specific Energy Education Standards in the Commission's Order on Consumer Education. RD, pp. 46-47.

PPL Electric proposes to continue to support the competitive retail market for electricity in its service territory by continuing its Consumer Education Plan during 2013 and beyond at the expense level approved by the Commission in its *Final Order on PPL Electric's Consumer Education Plan,* Docket No. M-2008-2032279 (July 18, 2008). To the extent that the

Commission concurs that consumer education regarding the retail market for electricity supplies and conservation is appropriate and supports such efforts through rate recoveries of related expenses, PPL Electric will continue to spend the amount authorized by the Commission on consumer education.

PPL Electric notes also that there may be some confusion with regard to the specific expenses that would be recovered through the CER. These costs should include the following:

- $5,482,220 for the Consumer Education Plan. PPL Electric St. 5-R, p. 29.
- $400,000 per year for the annual RMI postcard mailing to customers. RD, p. 129.
- A two-year amortization of the cost of the 2012 RMI postcards that were mailed by PPL Electric to its customers in February, 2012, at a total cost of $400,000. Recovery of these costs would include $200,000 per year during 2013 and 2014. RD, p. 127.
- A two-year amortization of the cost of the 2012 RMI Tri-Fold Brochure, a one-time mailing that is currently being prepared for mailing in November, 2012 at a cost of $400,000. Recovery of these costs would include $200,000 per year during 2013 and 2014. RD, p. 127.
- Any future amounts including, but not limited to, amounts related to the RMI EDC letter and amounts that may arise from programs included in the Company's proposed Default Service Plan, that are subject to separate and explicit approval.

In PPL Electric's view, all of these expenses should be recovered through the CER.

Exception No. 4: PPL Electric's Proposed Uncollectible Accounts Expense Should Be Allowed, In Full. RD, pp. 41-42.

The RD proposes to use a three-year average of uncollectible accounts expense to revenues to calculate the effect of the rate increase and proposes to disallow the adjustment to the reserve for uncollectible accounts. The RD proposed three-year average of 1.70% would disallow $554,000. RD, p. 42. In addition, the use of a three-year average would affect the calculation of the MFCs. PPL Electric proposed instead to use the percentage of its future test year write-offs to future test year revenues of 2.23% ($39,958,222 ÷ $1,789,413,551). As explained below, use of a three-year average should be rejected because it does not reflect current circumstances. The elimination of the adjustment to the reserve would reduce uncollectible accounts expense by $2,956,000. PPL Electric Exh. JMK-4. Elimination of the adjustment to the reserve would be improper because it disregards an important component of PPL Electric's actual expense.

As explained below, an historic three-year average is not appropriate because it is inconsistent with the ongoing increase in write-offs over the last three years and because the three-year average is inconsistent with actual, current data. The goal in this proceeding should be to set rates which reasonably reflect future conditions. The three-year average used in the RD included 2009, when PPL Electric's generation supply rates were capped. Since then, PPL Electric's electric supply rates for provider-of-last-resort service have increased significantly, when compared to prior periods when the generation supply rate cap was in effect. Not surprisingly, PPL Electric experienced increases in the number and dollar amounts of uncollectible accounts since the generation rate cap was ended. PPL Electric St. 8-R, p. 32.

2009	2010	2011
$24.6 million	$31.0 million	$38.7 million
	26%	25%

In addition, PPL Electric and its customers continue to experience the effects of the recession. PPL Electric St. 4-R, pp. 1-3. The unfavorable economic conditions adversely affect uncollectible accounts expense. Use of a three-year average where costs are increasing will, by definition, understate current costs. There is no basis for using a three-year history on these facts.

The error of relying on a three-year average is further demonstrated by PPL Electric's actual experience to date for the future test year. PPL Electric's proposed total uncollectible accounts expense for the future test year is $42.1 million. From January 1 through June 30, 2012, PPL Electric recorded actual uncollectible accounts expense of $15.8 million. PPL Electric Ex. JMK-6. When this amount is annualized using historic patterns of when uncollectible accounts expense is incurred, PPL Electric is on track to experience $45.0 million in uncollectible accounts expense in 2012, significantly more than its proposed uncollectible accounts expense for the future test year in this proceeding. PPL Electric St. 8-RJ, p. 3.[14]

Finally, elimination of the adjustment to the reserve would be improper because PPL Electric's actual, total uncollectible accounts expense includes charges in the reserve for doubtful accounts due to increased accounts receivable which are subject to write-off. PPL Electric St. 8-R, p. 32.

PPL Electric's total claim for uncollectible accounts expense is $42,098,866 (RD, p. 41), including both write-offs and additions to the reserve for uncollectible accounts. This amount is fully consistent with the latest available data in this proceeding and should be approved.

Exception No. 5: PPL Electric's Expenses For Environmental Management Services From PPL Services Should Be Approved. RD, pp. 29-30.

Like many utilities, PPL Electric is part of a larger corporate system that includes PPL Corporation and its direct and indirect subsidiaries. In order to control expenses and reduce duplication of functions within the PPL Corporate System, certain services are provided to PPL Electric and its affiliates from a central source, PPL Services Corporation ("PPL Services"). PPL Electric St. 3-R, p. 2. The Commission approved the formation of the holding company and the corporate system based on a finding that formation of the holding company would be in the public interest. *Application of Pennsylvania Power & Light Co.*, Docket No. A-11500, F. 206

[14] Typically, PPL Electric experiences about 35% of its total annual uncollectible accounts expense for each calendar year during the first half of the calendar due to the winter moratorium on residential customer terminations and termination procedures, including notifications, required under the PUC's regulations at 52 Pa. Code Ch. 56. $15.8 million ÷ .35 = $45 million.

(Feb. 10, 1995). The Commission also approved the affiliated interest agreement under which affiliated companies provide services.

The RD recommends that PPL Electric's expenses for environmental management services from PPL Services should be adjusted to an average, three-year historic level because PPL Electric did not adequately supported its budget for the future test year of $467,000. Instead, it recommends an allowance of $364,000. RD, pp. 29-30.

The goal of this proceeding is to establish rates that will reflect conditions during the future test year. PPL Electric has explained, in evidence, that a three-year average historic level of expenses should not be used to set rates for this expense because new regulations have been adopted that require PPL Electric to undertake greater levels of environmental management activities. More specifically, federal and state environmental rules now mandate routine inspection of storm water, erosion and sedimentation control measures both during and after construction involving ground disturbances. Previously, such regulations only required that such measures be inspected after the project had been completed. The need for ongoing inspections will increase environmental management expenses in and after 2012. PPL Electric St. 3-R, pp. 4-5. PPL Electric will also incur greater costs for environmental management in the future due to the increased level of construction activities. Construction activity has increased from $298 million in 2009 to $671 million in 2012 and is expected to increase further to $870 million in 2013. PPL Electric St. 10-R, p. 2. The increased construction activity means increased earth disturbance and increased need for environmental permits.

The environmental management costs included in the future test year budget include 1.5 full time employees to work on the implementation of the new Enviance software which PPL Electric will use to manage environmental permits and obligations. Although the implementation will be largely done by the end of the year, the budget also includes licenses for PPL Electric employees who will use the software to manage environmental permits and obligations. PPL Electric St. 3-R, pp. 4-5.

PPL Electric expects its future test year level of environmental management costs to to rise after 2012:

2013	2014	2015	2016	2017
$485,000	$494,000	$508,000	$549,000	$549,000

PPL Electric Ex. DAC-1, Sch. 3, p. 2; PPL Electric St. 3-R, p. 5. PPL Electric's future test year budget for environmental services expense ($467,000) has been fully supported and is reasonable given the increased level of activity in 2012 and beyond.

Exception No. 6: PPL Electric's Expenses For External Affairs Should Be Approved. RD, pp. 30-31.

PPL Services provides, in part, for the coordination of government relations activities, corporate communications, such as media and public relations services and community and economic development activities. PPL Electric's total future test year budget for external affairs is $2.602 million. PPL Electric St. 3-R, p. 7. PPL Electric has proposed an increase to its external affairs expense from $1,432,000 for 2011 to $2,602,000 for 2012.

The RD recommended a reduction of $620,000 to PPL Electric's budget down to $1,982,000. RD, pp. 30-31. Generally, the RD concluded that PPL Electric failed to give sufficient explanation for the increase in the expense. RD, p. 31. The RD is mistaken.

Unlike environmental management services, the increase in costs for external affairs is driven primarily by refinements to the process of identifying the affiliates who benefit from services, rather than an increase in the amount and costs of services provided. In fact, between 2011 and 2012, the overall cost of external affairs services for the entire PPL Corporate System increased from $10,888,000 to $10,982,000, a change of only 0.8%.

What did change between 2011 and 2012 was the means by which charges for external affairs are distributed among PPL Corporation's subsidiaries. Starting with 2012, much more of the costs of external affairs are directly charged as direct support rather than allocated as indirect support. The change to direct charges is demonstrated in PPL Electric Ex. DAC-1, Sch. 1.

The change from allocation of indirect charges to direct charges resulted from a management review of the day-to-day activities of the regional community relations directors, who are part of the External Affairs Department. These day-to-day activities primarily relate to reliability, connections and disconnections, billing and payment, street lighting and economic development. Within the PPL Corporate System, PPL Electric and PPL Electric alone benefits from these services. The review determined that the regional community relations directors spend the vast majority of their time working for PPL Electric. Consequently, a greater portion of these costs are directly charged to PPL Electric than had been the case in the past when such costs were allocated. PPL Electric St. 3-R, p. 7.

Separately, in recent years, increases in line siting and upgrading work, tree trimming and enhanced storm communications protocols have significantly added to the ongoing responsibilities of both the regional community relations directors and Corporate Communications, which also is within the External Affairs Department. Thus, although the increase in expenses for external affairs primarily is driven by a more accurate assignment of costs, there also is a smaller component results from increased activities and related expenses. PPL Electric St. 3-R, p. 7. PPL Electric's external affairs expense should be approved.

Exception No. 7: PPL Electric's Rate Case Expense Should Be Normalized Over Two Years. RD, pp. 42-44.

The RD rejected PPL Electric's proposal to normalize rate case expense over two years. Instead, the RD recommends that the rate case expense be normalized over 32 months which is the average time between the 2004 and 2007 rate case, the 2007 and 2010 rate cases, the 2010 and 2012 rate cases.[15] RD, pp. 43-44. Use of 32 months produces a reduction in annual normalized rate case expense of $258,000. Use of 32 months would be appropriate if past history of filing rate cases were a good indicator of the future. Here, however, it is not.

Much of PPL Electric's electric distribution system was constructed in the 1960s and 1970s. Much of the distribution system has a life expectancy of about 40 years. Therefore, much of the system is near or beyond the end of that lifespan. In late 2008, PPL Electric undertook a comprehensive study to assess the age, condition and performance of plant in order to develop a strategy for capital replacements in order to avoid the cost and reliability of service effects of aging infrastructure. Based on this study, PPL Electric embarked on a 10-year capital plan to replace, maintain and improve plant. PPL Electric anticipates adding $1.6 billion in plant from 2012 through 2016. PPL Electric Ex. Future 1A, pp. 3-4. Rate case history prior to 2010 does not reflect this construction program. Clearly, plant expenditures of this magnitude will necessitate a base rate case within two years, if not sooner. Under these circumstances, it is unreasonable to rely on a historic pattern of rate cases that extends back eight years to 2004 to determine the appropriate period for normalization of rate case expenses.

Exception No. 8: The RD's Proposed Adjustment to PPL Electric's Actual Lag Days For Payments To Its Affiliate Should Be Rejected. RD, pp. 18-20.

The RD adopts an I&E adjustment to the Company's lead/lag study to increase the payment lag for payments by PPL Electric to its affiliate PPL Services from 20 days to 60 days. This adjustment would reduce PPL Electric's cash working capital requirement by $13,166,000. For the reasons set forth below, this adjustment should be rejected

[15] All these rate cases were based on calendar year test years and were filed in late March.

The underlying facts are not in dispute. PPL Electric pays all invoices, both from PPL Services and thousands of invoices from non-affiliated vendors, using a computerized system. PPL Electric pays affiliates on the 20th day of the month after services are received. This results in a 35-day payment lag for services received by PPL Electric from its affiliates. That lag includes 15 days from the mid-point of the month in which services are received to the 20th day of the following month, when the invoices to its affiliates are paid. PPL Electric St. 7-R, p. 2. It is undisputed that PPL Electric's payment of invoices on the 20th of each month is commercially reasonable.

The RD proposes to increase the payment period for affiliate services from 20 days to 60 days because the affiliated interest agreement PPL Electric and its affiliates provides for a payment period of **up to** 60 days. PPL Electric Exh. 1, Attachment II D, 8e, p. 4. This is not an adequate basis for this adjustment. The agreement does not require 60 day payment; it says **up to** 60 days and clearly authorizes a 20-day payment period. Moreover, the affiliated interest agreement was entered into in 1995 — 17 years ago. PPL Electric Ex. 1, Attachment II-D-8a, p. 1. At that time, computers were not used to the extent that they are today and a longer time for payment of invoices was more common and reasonable. Today, however, with advances in technology, businesses pay invoices on a more current basis. The 60-day period permitted under the affiliated interest agreement provided flexibility and did not necessitate repeated filings of revised affiliated interest agreements as PPL Electric's payment practices improved with technological advances. The adjustment to PPL Electric's cash working capital requirement is unreasonable and should be rejected.

Exception No. 9: PPL Electric Should Be Permitted To Continue To Calculate The Postage Expense Component of Working Capital As Was Presented In This Proceeding. RD, pp. 20-22.

Though the RD did not recommend any adjustment to PPL Electric's working capital requirement related to postage expense, it criticized PPL Electric's calculation of the postage expense component of working capital and recommended that the calculation not be used in the future. RD, pp. 20-22. This recommendation is erroneous and should be rejected.

PPL Electric has fully explained its treatment of postage expense in rate base in its briefs. PPL Electric IB, pp. 26-27; PPL Electric RB, pp.13-14. Further, PPL Electric's treatment of postage expense has been approved previously by the Commission. *Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-00049255, Slip Op., pp. 11-12, 237 P.U.R. 4th 419, 2004 Pa. LEXIS 40 (Dec. 22, 2004). Nothing has changed since the Commission's decision in the 2004 case. The RD's recommendation should be rejected.

Exception No. 10: PPL Electric's Gross Receipts Tax Should Be Recovered In Full. RD, pp. 94-97.

PPL Electric's total future test year gross receipts tax expense is $50,102,000, which is comprised of two components. The first component is a pro forma calculation of gross receipts tax for the future test year present rates of $43,930,000 (PPL Electric Ex. Future 1, Sch. D-11, p. 3) and the second component is $6,172,000, which results from the proposed increase in rates (PPL Electric Ex. Future 1, Schedule D-12, p. 6).

The RD would adjust PPL Electric's gross receipts tax on the theory that PPL Electric pays gross receipts tax only on the revenues it actually receives, *i.e.*, total billed revenues less uncollectible accounts. RD, pp. 94-97. The adjustment would reduce PPL Electric's gross receipts tax by $934,000. RD, p. 94. The RD's recommendation, however, should be rejected because it disregards changes in the calculations of gross receipts tax imposed by the

Pennsylvania Department of Revenue in Corporate Tax Bulletin 2011-02, which was issued on July 20, 2011, This Tax Bulletin makes use of the deduction from gross receipts for uncollectible accounts next to impossible.

Under this Tax Bulletin, PPL Electric's liability for gross receipts tax is no longer limited to actual revenues received. Instead, PPL Electric is required to file gross receipts tax utilizing the accrual method of accounting. Consequently, under the Tax Bulletin, a reduction against taxable gross income for an uncollectible account requires PPL Electric to match each write-off to the tax period when the receipts reported as taxable to Pennsylvania. PPL Electric, at this time, does not have the capability to perform such tracking for the many write-offs of amounts for its approximately 1.4 million customers. PPL Electric St. 8-RJ (Part 1), pp. 36-37.

In rejecting PPL Electric's gross receipts tax calculation, the RD particularly relies on PPL Electric's testimony during cross-examination that the Company maintains records of customers' bad debts. RD, p. 97. That testimony is correct, but it provides no ability to enable PPL Electric to meet the onerous reporting and accounting requirements for gross receipts tax to take advantage of write-offs of uncollectible accounts to reduce the liability. It is correct that PPL Electric, for example, knows that hypothetical customer John Smith owed $100 which was written off July 1, 2012. In order to take advantage of the deduction to gross receipts for uncollectible accounts, however, PPL Electric is now required to determine exactly when that $100 was reported as receipts. That is not easily done. Assume the customer Smith entered into several payment arrangements and went through PPL Electric's Customer Assistance Program before the $100 was written off. The amount ultimately written off could have been billed originally several years ago and over an extended period of time. PPL Electric is not able at this time to determine for each amount written off when the amount was originally billed and reported to the Commonwealth of Pennsylvania as a gross receipt. Thus, the fact that PPL Electric maintains records of customers' bad debts does not resolve the dilemma imposed on PPL Electric by the gross receipts Tax Bulletin.

The RD's recommendation to disallow a portion of PPL Electric's gross receipts tax simply fails to recognize the realities of the obstacles that the Department of Revenue has placed on a corporation's ability to take advantage of the deduction from gross receipts for uncollectible accounts for gross receipts tax purposes.

III. CONCLUSION

For all the foregoing reasons, PPL Electric Utilities Corporation respectfully requests that the Pennsylvania Public Utility Commission grant the above Exceptions and approve the rate increase and other proposals in Supplement No. 118 to Tariff-Electric Pa. P.U.C. No. 201.

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