COMMONWEALTH OF PENNSYLVANIA
OFFICE OF SMALL BUSINESS ADVOCATE

November 19, 2012

E-FILED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Enclosed for filing are the Reply Exceptions, 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

Steven C. Gray
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 Exceptions, 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: November 19, 2012

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
v.	:	Docket No. R-2012-2290597
PPL ELECTRIC UTILITIES, INC.	:	

REPLY EXCEPTIONS
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

Steven C. Gray
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Dated: November 19, 2012

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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 6^{th}, 7^{th}, and 9^{th}, 2010.

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

On September 14, 2012, the OSBA submitted its Reply Brief.

On October 19, 2012, ALJ Colwell issued her Recommended Decision ("RD").

On November 8, 2012, the OSBA filed Exceptions to the RD. Exceptions were also filed by the Office of Consumer Advocate ("OCA") and Dominion Retail, Inc. d/b/a Dominion Energy Solutions ("DES").

The OSBA submits the following Reply Exceptions in response the Exceptions filed by the OCA and DES.

II. Reply Exceptions

A. Reply to OCA Exception No. 7: The ALJ properly recommended the adoption of the Company's cost of service study in this proceeding instead of the OCA cost of service study. (OCA Exceptions, at 18-31)

In its Exceptions, the OCA argued that the ALJ improperly recommended that PPL's cost of service study ("COSS") be used for the purposes of this proceeding. The OCA argued:

> PPL's cost of service study is flawed because it does not accurately reflect cost causation, is inconsistent with the 1992 NARUC Manual and the updated 2000 NARUC Report, and is inconsistent with the historical method that PPL used prior to 2010.

OCA Exceptions, at 18.

Specifically, the OCA argued that the change in the Company's COSS to allow primary distribution plant to be classified as 63% customer related and 37% demand related, instead of 100% demand related as classified by PPL in the past, is a methodological error and should be reversed. *See* OCA Exception, at 21-24.

The OSBA observes that OCA's reliance on PPL's past methodology can cut both ways. For example, in comparing PPL's cost classification proposed in 2012 with that approved by the Commission in 2010, Mr. Knecht stated:

> The Company's proposed plant classification factors in this proceeding are similar in magnitude to those used in the last proceeding. There is therefore no obvious indication that the Company has departed from the approved methodology. Overall, distribution plant (substations, poles, conductors, conduit, and transformers) were classified as 59 percent customer-related, 41 percent demand-related in the last proceeding at Exhibit JMK-2, and are classified as 55 percent customer-related, 45 percent demand-related in this proceeding. This modest reduction in customer-related costs generally has the effect of reducing costs allocated to residential and GS-1 customers, and increasing costs allocated to larger non-residential customers.

OSBA Statement No. 1, at 6.

Thus, the Company has actually proposed to *reduce* the customer component of distribution plant costs in the current proceeding relative to the method that was explicitly approved by the Commission in the Company's 2010 case, to the *benefit* of residential customers. In addition, as discussed more fully below, this demonstrates that the "goal posts" are not perpetually moving away from the residential class, which is the OCA's position.

Furthermore, in regard to secondary distribution plant, the OCA argued that the Company's methodology for determining the split of costs between customer related and demand related was defective. The OCA stated, as follows:

> In determining how much of the distribution plant to classify as customer related, the Company performed a minimum system study. [OCA witness] Mr. Watkins performed a systematic analysis of PPL's minimum system study, completely consistent with Commission precedent and the specific instruction contained in the 1992 NARUC Manual and found PPL's proposed customer/demand split suffers from several, serious shortcomings. As discussed below, these serious errors in PPL's minimum system study make it unsuitable for use in determining a customer/demand split.

OCA Exceptions, at 24-25.

OSBA witness Robert D. Knecht summarized the OCA changes to the Company's COSS, as follows:

> First, 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.

> Second, 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.

OSBA Statement No. 2, at 1-2.

Mr. Knecht found no new reason to support the OCA changes after the exact changes were litigated in PPL's 2010 base rates case. In rebuttal, Mr. Knecht stated:

> As I indicated in my direct testimony, in 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.

For the OCA to prevail on the issue of cost allocation, it must demonstrate *both* that the Commission erred in its decision in the 2010 base rates proceeding to allow for the classification of primary system distribution plant costs into both demand and customer components *and* that the Commissioned has consistently erred over the past decades in approving PPL's cost classification methodology for secondary distribution system costs. A brief examination of some of the key arguments that the OCA offers in its exception is set forth below.

First, the OCA excepts on the grounds that recognizing a customer component in primary distribution system costs is inconsistent with Commission decisions prior to 2010. This is an unpersuasive argument, since the Commission considered virtually all of the evidence presented by the OCA in this proceeding in the 2010 base rates proceeding, and rejected the OCA's conclusion. Moreover, in this proceeding, the OCA is objecting to PPL's method for classifying secondary system plant costs, an approach that PPL has used for years if not decades. The Company has provided examples of where OCA proposes to change PPL's cost classification methods that have been in place for years. *See* PPL Statement No. 8-R, at 23 and 28. In effect, in OCA's view, Commission precedent prior to 2010 is relevant only if it favors residential customers. The OSBA submits that OCA's reliance on precedent is therefore both wrong and internally inconsistent.

Second, the OCA relies on the assertion that regulatory bodies in more than 30 states do not include any customer component in classifying either primary system or secondary system distribution costs. As the Commission is well aware, cost allocation is often hotly debated among the parties to a regulatory proceeding. However, the economic issue of the classification of distribution plant costs is essentially an issue involving residential and small to medium business customers. Large industrial customers are generally served at transmission voltage and have no stake in this question. Since small and medium business customers are generally unrepresented in utility regulatory proceedings, it is unclear whether the regulatory pattern alleged by the OCA results from hard cost analysis, or simply lack of representation. In either event, the 30 jurisdictions which allegedly classify distribution plant costs as 100 percent demand-related are all necessarily ignoring the basic principle that Mr. Knecht described in PPL's 2010 case, and which the Commission at least implicitly accepted:

> Conceptually, distribution plant costs are incurred for two reasons. First, the poles, conductors and transformers must be sized to meet the peak demand load of all customers served by that plant under peak demand conditions. For that reason, cost allocation experts recognize that distribution costs have a peak demand component.
>
> Second, electric distribution systems must be constructed to interconnect each customer served by the utility to the distribution network, and eventually to the substation where the distribution network attaches to the transmission grid. The costs incurred to provide this service are related primarily to the distance from the substation to the customer and the geographic density of the customer base. Similarly, the number of transformers required to step down primary to secondary voltage are related to the geographic distribution of customers. Distribution plant costs are therefore also influenced by the location of the utility's customers, relative both to each other and to the transmission grid. As an estimate of this distance-related cost causation factor, many utilities use customer count as a proxy. The use of this proxy is based on the hypothesis that longer distribution lines are generally required to interconnect one hundred smaller customers with a maximum demand of 10 kW than ten larger customers with peak demand of 100 kW. Or, to put it another way, electric distribution system costs exhibit economies of scale with respect to the size of the customer -- larger customers typically cost less to serve per unit of demand than smaller customers.
>
> Therefore, it is relatively common for distribution utility cost of service studies to classify electric costs into both peak demand and customer components. This is the general approach that is recommended in the NARUC Electric Utility Cost Allocation Manual ("NARUC Manual").

OSBA Statement No. 1 at 14-15, Docket No. R-2010-2161694

The OSBA submits that this principle has long been followed in Pennsylvania, and that the alleged practices of other jurisdictions are irrelevant.

Third, the OCA relies on what it refers to as the "updated NARUC report." The OSBA respectfully submits that the characterization of this report as an update to the 1992 Cost Allocation Manual is deceptive at best. The 1992 Cost Allocation Manual was published as a NARUC Report. The report to which OCA refers to as an update is nothing of the kind. It is not a cost allocation report prepared by NARUC, but is in fact a report prepared by Mr. Frederick Weston of the Regulatory Assistance Project entitled "Charging for Distribution Utility Services: Issues in Rate Design." OCA Statement No. 1, Schedule GAW-4. It contains a relatively brief chapter related to distribution system cost allocation, that, unlike the 1992 NARUC Cost Allocation Manual, contains little in the way of specifics for distribution cost classification and allocation. Moreover, while OCA witness Mr. Glenn Watkins appears to have excluded it from the excerpts he included in his testimony, the report is publicly available and the acknowledgements section of that report states:

> Lastly, this report was prepared by the Regulatory Assistance Project for the National Association of Regulatory Utility Commissioners, under a grant from the Energy Foundation. The views and opinions expressed herein are strictly those of the authors and may not necessarily agree with, state, or reflect the positions of NARUC, the Energy Foundation, or those who commented on the paper during its drafting.

See
http://www.raponline.org/docs/RAP_Weston_ChargingForDistributionUtilityServices_2000_12.pdf

Thus, while this report doubtless reflects Mr. Weston's personal views, the OSBA notes that Mr. Weston is not an expert in this proceeding, the evidence in his report has not been subjected to discovery and cross examination, and his views are inconsistent with long-standing Commission precedent. The OSBA recommends that the Commission give no weight to this consultant's report.

Fourth, the OCA presents the venerable Professor Bonbright and his oft-cited views on cost classification within embedded cost of service studies. The OSBA respectfully submits that the Commission has seen this particular bit of evidence many times before, and it has obviously rejected its applicability to PPL. In the short passage cited by OCA in its exceptions, Professor Bonbright concludes that there is little evidence that utility distribution costs are dependent on the number of customers. With all due respect to Professor Bonbright, such a conclusion defies common sense. More customers require more poles, more cable, and more transformers. Moreover, Professor Bonbright's conclusion must be based on some statistical analysis that was presumably done in the distant past, was not specified or introduced by OCA in this proceeding, is of no known relevance to PPL, and which can no longer be reviewed, analyzed or validated. Moreover, Professor Bonbright is not (and unfortunately can no longer be) a witness in this proceeding, making it difficult to assess the basis for this one narrow conclusion.

Fifth, the OCA presents evidence prepared by Mr. Watkins that the distribution of residential and commercial customers within PPL's service territory is similar in urban and rural geographic areas. This issue, too, was vetted in 2010. The OSBA responded to this issue in that proceeding, and the OCA's argument was rejected. Mr. Knecht testified in the 2010 proceeding, as follows:

> Q. Mr. Watkins goes on to state, '. . . there may be considerable differences in both customer densities and mix of customers throughout a utility's service area. . . . If the distribution of customers (customer mix) is relatively similar in both the rural and urban areas, there is no need to consider customer counts (number of customers) within the allocation process, because all classes use the utility's joint distribution facilities proportionately across the service area.' Do you agree with this argument?
>
> A. No, I do not. All electric distribution systems are designed both to meet peak demand and to interconnect all customers. All electric distribution systems therefore have costs that should be classified into demand and customer components. The NARUC Electric Utility Cost Allocation Manual makes no distinction between urban and rural distribution systems when it specifies that distribution plant should be classified into demand and customer components. Certainly, electric distribution systems that serve a more densely populated area are likely to have a higher demand component and a lower customer component than electric distribution systems in more sparsely populated rural areas. However, this difference will be reflected in the results of

minimum system and zero-intercept methodologies used to classify distribution costs.

The analysis that Mr. Watkins performs regarding geographic customer mix by rate class does not address the issue of whether or not a customer component is appropriate. Instead, Mr. Watkins' analysis addresses the issue as to whether the classification analysis should be segregated into separate, regional analyses rather than be performed on a systemwide basis. When a standard, system-wide zero-intercept or minimum system classification study is performed, the implicit assumption is that customers are evenly distributed throughout urban and rural areas. That is, the systemwide classification analysis assumes that if the systemwide residential share of total customers is 70 percent, that residential customers represent 70 percent of rural customers and 70 percent of urban customers. However, if that assumption is not correct, the systemwide classification analysis (minimum system or zero-intercept) will produce biased allocation results. For example, if the classification analysis is disaggregated by geographic region, the urban areas may have an average customer component of 30 percent, while the rural areas may have an average customer component of 70 percent. Because it is done system-wide, the classification study produces only the average, say 50 percent. If, for example, the mix of residential customers is higher in the more costly rural areas, the 50 percent customer classification factor will under-assign costs to residential customers. Suppose, for example, that residential customers represent 70 percent of total customers, but they constitute 80 percent of rural customers and 60 percent of urban customers. Under those circumstances, it would not be appropriate to use systemwide averages for allocating costs, because the cost to serve in rural areas is higher than the cost to serve in urban areas. Rather, the classification and allocation analysis would need to be segregated into urban and rural components.

More detailed examples of how the systemwide classification analysis is affected by geographic mix are shown in Exhibit IEc-R1. That exhibit demonstrates that if the geographic mix is uniform, the standard classification method is reasonable. It also demonstrates that if residential customers constitute a higher share of PPL Electric's customer mix in rural areas than they do in urban areas, the costs assigned to the residential class in the standard classification method will be understated.

In effect, Mr. Watkins' analysis of geographic customer distribution does not evaluate whether the classification analysis is

> correct; it evaluates whether the systemwide classification analysis should be further disaggregated into urban and rural distinctions. Mr. Watkins' analysis is therefore not relevant to demonstrating whether distribution plant costs have both a customer and demand component. If it were definitive, his analysis would demonstrate only that the system-wide classification analysis does not need further adjustments to reflect a higher mix of residential customers in rural areas.
>
> Q. Is Mr. Watkins' analysis definitive?
>
> A. No, it is not. Simply determining customer mix by the smaller geographical areas that Mr. Watkins uses is not sufficient to determine whether residential and non-residential customers are proportionately spread out. In general, within any particular geographic area, commercial enterprises tend to be concentrated in town centers, shopping centers, and other discrete areas while residential customers tend to be more spread out. The cost per customer of attaching the more densely packed businesses within each geographic area is therefore likely to be less than the cost of attaching the residential customers. Unless Mr. Watkins' analysis is done at a much more detailed level than that presented in his testimony, it will fail to recognize these effects.

OSBA Statement No. 2, at 3-5 (Docket No. R-2010-2161694).

Sixth, the OCA argued that the Company's changing cost allocation methodologies creates a "perpetual bias" against the residential class, and that this is the reason why the residential class continues to under-recover allocated costs. The OSBA agrees that the cost allocation changes implemented in 2010 relating to primary system distribution costs increased costs assigned to residential and the smallest business customers in Rate GS-1 relative to the previous methodology. However, that change was a one-time event and not any indication of "perpetual" increases being assigned to the residential class. Moreover, as detailed earlier, the proposed changes in *this* proceeding *reduce* costs assigned to the residential class relative to the 2010 approved methodology.

Interestingly, the OCA bases its argument that the residential class revenues never seem to catch up to allocated costs on two tables. OCA Exceptions, at 29. Those tables purport to show that the indexed rate of return for the residential class coming out of the 2010 case (78.61 percent) declined to 63.03 percent coming into the current case. Or, similarly, the indexed rate of return for the GS-3 class was 250.06 percent coming out of the last case and 285.18 percent coming into the current case. From those tables, the OCA somehow concluded that the residential class lost ground in the current case as a result of cost allocation changes. OCA offers no credible evidentiary support for this leap of faith, likely because its conclusion is flawed for two very simple reasons.

First, OCA relied on the flawed indexed rate of return metric. With this metric, it is not at all surprising that each rate class moves farther away from allocated cost from the end of one case to the beginning of the next case. Consider a simple example: at proposed rates for the end of a particular rate proceeding, a class has a rate of return of 6 percent compared to a system average return of 8 percent, an indexed rate of return value of 75 percent (6/8 = .75). If costs increase uniformly for both the class and the system, the rates of return will drop by roughly the same amount. So, for example, with a uniform cost increase from one case to the next, the class return could drop from 6 percent to 4 percent, while the system return drops from 8 to 6 percent. The resulting indexed rate of return going into the next case is 67 percent (4/6 = .67). In effect, the indexed rate of return dropped from 75 percent to 67 percent with no change in cost allocation at all. Thus, the result shown by OCA is to be expected and is therefore indicative of nothing with respect to cost allocation. (The OSBA notes that this is just one more reason why the indexed rate of return metric should be relegated to the scrap heap as an analytical tool.)

Second, OCA is not comparing apples to apples. The results coming out of the last case are not at actual approved rates, but are in fact at the rates *proposed* by PPL in the 2010 proceeding at the full PPL proposed revenue requirement. As OSBA explained in its testimony, its briefs, and its exceptions in this proceeding, the use of the proportional scaleback *reduces* progress toward cost-based rates from that which was originally proposed at the full revenue requirement. Thus, when the proportional scaleback was applied in 2010, it reduced the progress toward cost-based rates in the Company's proposal at the full revenue requirement. This effect can be seen in Table IEc-S1 in Mr. Knecht's surrebuttal testimony, which shows the impact of I&E witness Mr. Hubert's proposed scaleback (a proportional scaleback with modest first dollar relief effects). As shown in that table, the proportional scaleback reverses much of the progress toward cost-based rates contained in the rates designed to meet the full proposed revenue requirement. Thus, at least some of the effect observed by OCA is due to a flawed scaleback mechanism, rather than any unidentified changes in cost allocation.

The OSBA therefore respectfully submits that if it is OCA's goal to stop the "perpetual" above-system average increases for the residential class, the best approach would be to grant OSBA's exception to the proportional scaleback mechanism and adopt a mechanism which does not push even more of the problem off to the next case.

Therefore, the OSBA respectfully requests that the Commission deny OCA Exception No. 7 and uphold the ALJ in adopting the Company's COSS for use in this proceeding.

B. <u>Reply to OCA Exception No. 8</u>: The ALJ properly recommended the Company's revenue allocation at the full revenue requirement. (OCA Exceptions, at 31-34)

In its Exceptions, the OCA argued for changes to the Company's COSS methodology, as set forth above, but also an allocation of the revenue increase based upon the OCA's COSS results. *See* OCA Exceptions, at 31-34 ("[T]he OCA's COSS should be adopted as a guide to set rates in this proceeding and for purposes of establishing a fair and reasonable allocation of the revenue increase.")

As the OCA readily admits, the adoption of the OCA's revenue allocation proposal requires the Commission to agree to the OCA's version of the COSS. Because the ALJ correctly rejected the OCA cost allocation methodology, the OCA's revenue allocation methodology must also necessarily fail.

Therefore, the OSBA respectfully requests that the Commission deny OCA Exception No. 8 and uphold the ALJ in adopting the Company's revenue allocation at the full revenue requirement.

C. <u>Reply to DES Exception No. 1</u>: The ALJ recommended that the uncollectible rates be set at 1.70% for the Company's residential customer class. (DES Exceptions, at 3-5)

PPL incurs uncollectibles costs related to both its distribution revenues and its gas supply revenues. With respect to the gas supply revenues, PPL incurs uncollectibles costs from both default service customers and from those shopping customers whose receivables PPL purchases from EGSs under its purchase-of-receivables ("PoR") program. PPL recovers the gas supply uncollectibles related to default service customers in the Merchant Function Charge ("MFC"), which is based on a *class-specific* percentage of the gas supply charge. PPL recovers the gas supply uncollectibles related to shopping customers in the form of a *class-specific* purchase price discount in its PoR program. For each rate class, the percentage factors used for the MFC and the PoR discount are the same, and are generally based on some measure of PPL's historical uncollectibles experience.

In its Exceptions, DES noted that "the ALJ concludes that I&E's proposed 1.7% uncollectible rate is 'reasonable and recommended for approval.'" DES Exceptions, at 3. DES then argued:

> DES submits that the ALJ should have concluded that the 1.7% uncollectibles expense rate that she adopted for ratemaking purposes should be the same number as the POR [Purchase of Receivables] discount. There is no real dispute in this case that the POR discount is the same as the uncollectible rate. Moreover, the record is unambiguous that PPL currently does not track uncollectibles separately as between shopping and non-shopping customers.

DES Exceptions, at 4.

The OSBA respectfully observes that, although the DES language quoted above does not say so, DES is addressing the residential class uncollectibles rate. Unfortunately, for the majority of the DES Exceptions, the 1.70% is referred to as "the uncollectibles rate" when it is, in fact, just the rate for the residential customers. Not until the concluding paragraph does DES clarify that "the ALJ erred by not translating directly and immediately the 1.7% uncollectibles expense rate ... into the POR discount for residential customers." DES Exceptions, at 6. While the OSBA agrees with DES that the uncollectibles rate determined for the residential class should be used to develop both the residential MFC and the residential PoR discount, the OSBA cautions that the 1.70 percent factor is not appropriate for the non-residential classes. The Small C&I and Large C&I MFC and PoR discount rates should reflect the uncollectibles rates applicable to those classes.

III. Conclusion

For the reasons set forth herein, the OSBA respectfully requests that the Commission deny OCA Exceptions Nos. 7 and 8, and clarify DES Exception No. 1.

Respectfully submitted,

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Dated: November 19, 2012