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

IN REPLY PLEASE
REFER TO OUR FILE

November 19, 2012

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

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

Dear Secretary Chiavetta:

Enclosed please find an original of the Bureau of Investigation and Enforcement's (I&E) **Reply Exceptions** in the above-captioned proceeding.

Copies are being served on all active parties of record as evidenced in the attached Certificate of Service. If you have any questions, please feel free to contact me at (717) 783-6155.

Sincerely,

Regina L. Matz

Regina L. Matz
Prosecutor
Bureau of Investigation and Enforcement
PA Attorney I.D. #42498

Enclosure
RLM/edc

cc: Parties of Record
Hon. Susan D. Colwell
Robert F. Powelson, Chairman
John F. Coleman, Jr., Vice Chairman
Wayne E. Gardner, Commissioner
James H. Cawley, Commissioner
Pamela A. Witmer, Commissioner
Chief Counsel Pankiw, Law Bureau
Director Cheryl Walker Davis, OSA

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

BUREAU OF INVESTIGATION AND ENFORCEMENT
REPLIES TO EXCEPTIONS

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Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
P.O. Box 3265
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Dated: November 19, 2012

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I. INTRODUCTION

Before the ALJ, PPL postured this case as a bellwether for the utility industry on a national scale. Claiming solitary travels on the regulatory high road, PPL contended it abided by "fundamental ratemaking principles and established Commission precedent," while I&E and OCA "ignored" these principles and proposed adjustments which, PPL caterwauled, would "destroy [the Company's] financial integrity."[1] While PPL justified this case on four grounds – lower revenue from lower usage and a stagnant economy, capital investment, support for competition, and storm damage – I&E demonstrated that PPL's claims were overstated and favored PPL's affiliated family of companies.[2]

For example, PPL's requested rate of return alone accounted for $73 million of I&E's proposed adjustments. Through PPL Corp.'s own reports to investors, I&E proved that the pressure of sustaining its parent's earnings is the real force behind the filing:

> **PPL Corp**.'s business mix is now **heavily weighted toward rate-regulated earnings**;
>
> **Rate-regulated earnings provide stability and security to PPL Corp**.'s earnings forecasts and its dividend;
>
> **Rate-regulated earnings support PPL Corp.**'s "Excellent" business risk profile rating by S&P and provide stable ratings outlooks;
>
> **Rate-regulated earnings secure PPL Corp.'s dividend** and support a platform for continued growth, increasing the dividend by 44% since 2005, providing shareowners a 17.5% return for 2011 attaining the high end of the company's 2011 forecast of $2.55-$2.75/share, outperforming the S&P 500 Index for 2011, and ensuring continued dividends that have already spanned 260 consecutive quarters – or an astounding 65 years of uninterrupted dividends;
>
> **Rate-regulated earnings provide significant growth prospects** with operations in "constructive" jurisdictions;

[1] PPL M.B. at 8.
[2] I&E M.B. at 5-6.

> **The bottom line is this: Without the additional earnings from these rate-regulated operations, PPL [Corp.'s] earnings per share would be significantly depressed for 2012 and the foreseeable future[.]** The fundamental driver of [PPL Corp.'s] acquisitions in 2010 and 2011 [of more rate-regulated entities] was reducing risk for [PPL Corp.] at a time of unprecedented turmoil in competitive electricity markets.[3]

While it is reasonable to expect PPL Electric to contribute to PPL Corp.'s earnings, the Commission must carefully scrutinize the rate-regulated operations to assure that PPL Corp.'s financial growth is sustained by *all* PPL's affiliates, not just PPL Electric.

Recommending a 9.68% ROE and rejecting multiple PPL expense claims that were inextricably entangled with affiliate financial interests, the ALJ's decision accomplishes that result. PPL's 11.25% requested ROE was pumped up with "risk" boosters whose necessity was expressly refuted by PPL Corp.'s own investor reports. The ALJ also recognized that PPL's affiliate transactions, from insuring against loss with an affiliate and withholding claims for over a year while at the same time paying affiliate expenses earlier than necessary, presented financial opportunities at ratepayer expense.

Today's economy is struggling to recover from the largest stock market crash since the Great Depression where investor returns sank to half their value. Families still face unemployment and lingering financial strains. PPL Corp. reported, however, that since 2005 it increased dividends in 7 out of 8 years and experienced 44% dividend growth. Also, 94% of PPL's proposed $104.6 million revenue increase lay in this Commission's resolution of issues that impacted PPL affiliates.[4] Although PPL Electric claimed reduced revenues, a stagnant economy, and capital needs drove this case, I&E's

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[3] I&E M.B. at 78-79, quoting from I&E Cross-Examination Exs. 7 (PPL Corp. 2011 Annual Report to Shareholders); 6 (PPL Corp. Investor Presentation September 20, 2011); 5 (PPL Corp. May 15, 2012 Press Release Statement of PPL Chairman, President and Chief Executive Officer William H. Spence); Tr. at 291 (emphasis added).

[4] I&E M.B. at 6-7; I&E R.B. at 5-6.

analysis of the corporate family's reliance on PPL Electric for earnings raised serious concerns. Affiliate transactions increased PPL's cost of service to ratepayers and cast a pall over PPL's claim to regulatory excellence. While recognizing it is the financial health of PPL Electric and not its affiliates at issue here, I&E respectfully contends that the evidence adduced justifies grant of I&E's Exceptions and denial of PPL's.

II. REPLIES TO EXCEPTIONS

A. Rate Base – Cash Working Capital

1. O&M – Calculation of Expense Lag Days – The ALJ properly recommended that PPL abide by its affiliated interest agreement in calculating the O&M expense lag in CWC. (R.D. Pages 18-20; I&E M.B. Pages 10-14; I&E R.B. Pages 8-11)

The ALJ recommended that PPL's calculation of its expense lag days based on its early payment to its affiliate be rejected based on I&E's evidence that the Company paid its affiliate for services rendered well in advance of when payment was required, contributing to a substantially shorter expense payment lag and an unnecessary annual ratepayer CWC contribution of $1.1 million.[5] PPL excepts, claiming that its affiliated interest agreement allows for payment of expenses **up to** 60 days after invoice, that the affiliate agreement is 17 years old, and that with computerization, it pays all bills, from affiliates and non-affiliates, in the same way which is commercially reasonable.[6]

PPL offered no evidence in the proceeding of constraints of its "computerized system" nor did it allege that its computer programming cannot be changed. Rather, this claim is fabricated for the first time in Exceptions. As an issue raised for the first time in Exceptions, it should be ignored.

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[5] R.D. at 20.

[6] PPL Exceptions at 35-36.

PPL cannot dispute that its affiliated interest agreement allows it to take advantage of a much longer payment period to affiliates. As I&E's witness concluded:

> Ratepayers should not suffer the financial consequences of the Company's election to pay its affiliate 40 days early. The Company's affiliate, and not its ratepayers, benefit from PPL's early payment to its affiliate. Therefore the costs of the Company's choice to pay its affiliate earlier than obligated should not be borne by ratepayers since the ratepayers derive no benefit from such early payment, and in fact would be penalized through an increased CWC claim.[7]

PPL should be required to save ratepayers $1.1 million annually by paying its affiliate as allowed. A million here and there may not concern PPL but it should alarm the Commission, particularly where PPL's indifference disadvantages ratepayers and benefits affiliates. PPL's choice to ignore this agreement and pay its affiliate when it pays other unaffiliated vendors may be convenient and typical for unregulated private transactions. However, a regulated monopoly with captive ratepayers making payments to affiliates should be held to a different standard.

While PPL also complains that its affiliated interest agreement is 17 years old,[8] it is clearly within PPL's power to update that document. In fact, in September 2012 the Bureau of Audits released the results of its Management Efficiency Investigation evaluating PPL's implementation of recommendations from its 2009 Management Audit Report. As noted therein, PPL had yet to update its affiliated interest agreement despite Audits' recommendation to do so in its 2009 Management Efficiency Audit.[9]

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[7] I&E St. 2-SR at 62.

[8] PPL Exceptions at 36.

[9] I&E requests the Commission take official notice of this fact in the Audit Report pursuant to the Commission's authority at 52 Pa. Code §5.408. The Audit Report also qualifies for evidentiary consideration under Section 5.406 of the regulations as a public document on file at the Commission.

2. Miscellaneous CWC – Calculation of Postage Expense – The ALJ correctly determined the Company overstated postage. (R.D. Pages 20-22; I&E M.B. Pages 17-18; I&E R.B. Pages 14-15)

When calculating CWC, expenses are allocated to O&M, prepayments, accrued taxes, or interest payments. PPL included postage expense as both an O&M expense and a prepayment, including a full 12-month expense dollar amount claim for postage in its total CWC O&M expense as well as in its CWC Prepayment, resulting in a funding claim greater than what is actually incurred. I&E proposed no adjustment, but requested the Commission to order the Company to correctly calculate its postage expense in future proceedings. The ALJ agreed.

Relying solely on its 2004 base rate case[10] in which it alleged the OCA raised, and lost, the same issue, PPL urges the Commission to reject the R.D. However, the ALJ specifically found that PPL's 2004 case was distinguishable because in that case OCA had not provided evidence that the Company included both a prepayment and an expense for the same item, but in this case PPL admitted that it did. This distinction, the ALJ found, would have altered the 2004 recommendation. PPL's CWC claim for postage expense is overstated because whether loaded into a meter or directly expensed postage is, in fact, "paid for only once."[11] The ALJ's recommendation should be adopted.

B. Expenses

3. Uncollectibles Expense – the ALJ correctly allowed the Company to recover its uncollectibles expense in full. (R.D. Pages 41-42; I&E M.B. Pages 20-23; I&E R.B. Pages 16-18)

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[10] *Pa. P.U.C. v. PPL Electric Utilities Corporation*, 99 Pa. P.U.C. 389, 2004 WL 3119796 (Pa. P.U.C.) (2004) ("*PPL 2004 Base Rate Case*").
[11] R.D. at 22.

PPL's proposed uncollectibles expense rate of 2.23% was based upon its expected write-offs plus a reserve for "doubtful accounts" subject to "*potential* write-off."[12] I&E reduced the Company's claim based upon I&E's calculation of an uncollectible expense rate of 1.70%, calculated using the Company's most recently experienced multi-year actual residential write-off amounts compared to its recent historic billed revenues to consider year-to-year variability and smooth out volatility. I&E confirmed the reasonableness of its calculation by comparison to both the Company's actual 3-year and 5-year historic averages, which yielded a similar actual uncollectible rate of 1.70%.[13] The ALJ agreed and recommended adoption of I&E's adjustment. As the ALJ found, I&E's 5-year calculation yielded a similar rate and evaluated data from 4 years of recession and 2 years of sales and write-offs following removal of the rate cap, thus confirming the reasonableness of I&E's uncollectible rate of 1.7%.[14]

PPL excepts to the ALJ's recommendation alleging it "does not reflect current circumstances" and that the 1.70% is inconsistent with what it characterizes as an "ongoing increase" in uncollectibles over the last three years, which includes one year of capped rates and a recession that is continuing beyond the HTY.[15] PPL also cites to its experience from January 1 through June 30, 2012 to support a higher rate.

PPL ignores the facts, cited by the ALJ, that the 5-year average, commencing in 2007 and going through 2011, includes not only two years of data following removal of the generation rate cap (2010 and 2011), but also four years of data from the continuing

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[12] PPL St. 8-R at 32 (emphasis added).
[13] I&E M.B. at 20-21.
[14] R.D. at 42.
[15] PPL Exceptions at 30. I&E notes that while PPL characterizes the recession as continuing for purposes of calculating its uncollectibles, with respect to arguing for an 11.25% ROE, PPL claimed that the economy is in recovery and that the recession's historically low interest rates will not last. PPL M.B. at 87.

recession (2008, 2009, 2010, and 2011). While citing an increase in the number of accounts and uncollectible dollars from 2009 through 2011, PPL misconstrues those facts to claim there is an "ongoing increase" over the last three years. In fact, when presented as a percentage of overall revenues, the manner for calculating the uncollectibles rate, the evidence does not support an "ongoing increase." The 2009 rate of 1.63% was *lower* than the 2008 rate of 1.72%; the 2010 rate of 1.49% was *lower* than both the 2008 and 2009 rate. The 2011 rate of 1.97%, albeit increased slightly, is still substantially *lower* than PPL's claimed 2.23% on both a stand-alone and averaged basis. Even a simple 2-year average of data from 2010 and 2011, which excludes the rate cap period and includes only recessionary data, confirms I&E's 1.70% calculation.[16]

The facts do not support PPL's claimed rate unless the Commission looks at only a snapshot of six months of experience in the first part of the FTY and then extrapolates that to an assumed level. However, this Commission has never calculated an allowed uncollectibles expense rate on this basis, particularly when the most recent 2-, 3-, or 5-year averages belie that rate. Further, I&E's calculation comports with the Commission's regulations, the Company's own calculation of other claims, and PPL calculation of its uncollectibles expense in both its 1985 and 2010 rate cases.[17] PPL's claims that the ALJ's allowance understates PPL's experience and that a 3-year average fails to reflect ongoing increases is inaccurate. The ALJ's recommended uncollectibles rate should be adopted.[18]

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[16] I&E M.B. at 23.
[17] I&E R.B. at 17-18. Although apparently no longer contending that using "actual costs" for ratemaking "has not been the requirement in this jurisdiction for at least 35 years," (PPL St. 8-RJ (part 1) at 4), the Company's conclusion that there is no basis for using a 3-year history is factually and legally wrong. *See* 52 Pa. Code §53.53, Exhibit C, General Filing Information – Electric Utilities, Part II.D.5; I&E M.B. at 22.
[18] The 1.70% should also be used in the Company's Purchase of receivables (POR) program and the associated Merchant Function Charge (MFC). I&E St. 2 at 5-7; I&E M.B. at 20-21.

4. **Rate Case Expense – the ALJ correctly computed the normalization period based upon PPL's past filing history.** (R.D. Pages 42-44; I&E M.B. Pages 24-26; I&E R.B. Pages 18-19)

I&E adjusted PPL's proposed 24-month normalization period to 32 months to reflect PPL's actual filing history since 2004 when PPL began filing rate cases at regular intervals. This resulted in an adjustment of $258,000. The ALJ recommended adoption of I&E's proposal as based on solid evidence.[19] Citing no error by the ALJ, PPL repeats the same argument rejected by the ALJ, namely that because of infrastructure plans, rate case history prior to 2010 is not an accurate reflection of the Company's future rate case plans.

In brief PPL equivocated that "it is *difficult to see* how such a significant increase in rate base and plant in service *would not drive* a rate case during 2014 or before."[20] In Exceptions PPL more stridently contends that "plant expenditures of this magnitude *will necessitate* a base rate case within two years, if not sooner."[21] Under either speculation, however, the law is well-settled that absent exceptional circumstances rate case expense is normalized based upon a party's filing history and not its presently stated intentions no matter how unequivocally declared.[22] There are no exceptional circumstances. Indeed, there are mitigating circumstances in the form of the effect of the Distribution System Improvement Charge (DSIC), which, while now ignored by PPL, was initially sought by PPL in its 2004 rate case, and then so anxiously lobbied for and anticipated by PPL Corp. that it tracked and reported its progress through the General Assembly to investors on a monthly basis until Act 11 was signed by the Governor.[23]

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[19] R.D. at 44.
[20] PPL M.B. at 76 (emphasis added).
[21] PPL Exceptions at 35 (emphasis added).
[22] *Popowsky v. Pa. P.U.C.* 674 A.2d 1149, 1154 (Pa. Cmwlth. 1996) ("*1996 Popowsky*"); *Pa. P.U.C. v. Borough of Media Water Works*, 72 Pa P.U.C. 144 (1990).
[23] I&E M.B. at 104-06.

PPL has been finely attuned to its infrastructure needs since 2004 when it began regularly filing rate cases. Contrary to PPL's characterization, the Company's current infrastructure improvement plan is not a sudden development that renders its recent rate case history irrelevant. Just two months ago the Commission rejected a similar argument in which the Borough of Quakertown disputed a 7-year normalization based on filing history because anticipated intensive capital construction was under contract and had broken ground with an estimated 2013 completion date. In affirming the ALJ, the Commission found that if the Borough filed sooner it "may be appropriate to consider a shorter normalization period going forward."[24] That is the appropriate resolution here.

5. Affiliate Support – Environmental Management Expense – The ALJ correctly recommended a reduction of PPL's claimed expense to its affiliate for environmental services. (R.D. Pages 29-30; I&E M.B. Pages 32-34; I&E R.B. Pages 25-26)

I&E proposed a $103,000 adjustment to the Company's claim for payment to its affiliate for environmental management services because the Company's claim contained costs that were irregular, erratic, and unsupported in the FTY. PPL excepts, asserting 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[,]"[25] the same assertion reviewed and rejected by the ALJ.

The ALJ found PPL failed to support additional costs associated with compliance. Aside from the Company's claims for new Environmental Management System (EMS) implementation and going-forward costs, which I&E built into its adjustment, PPL set

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[24] *Pa. P.U.C. v. Borough of Quakertown*, Docket No. R-2011-2251181 (Order entered September 13, 2012), Slip Opinion at 37.

[25] PPL Exceptions at 32.

forth cost projections through 2017 that were substantiated solely by the Company's claim that new regulatory burdens would increase construction and management costs. Yet the only specifics provided were allegations of "routine inspection of stormwater and erosion and sedimentation control (after a project is completed) and other more stringent environmental and local rules.[26] More importantly, I&E demonstrated that despite PPL's claims before the Commission that environmental compliance costs will increase substantially, PPL Corp. contended otherwise in its reports to investors where PPL reported not only no environmental downside for its distribution system, noting "[n]o significant exposure to currently proposed environmental regulations," but also "significant upside" for generation.[27] The ALJ's recommendation should be adopted.

6. **Affiliate Support – External Affairs Expense – the ALJ correctly rejected PPL's proposed expense allocation.** (R.D. Pages 30-31; I&E M.B. Pages 34-37; I&E R.B. Pages 26-29)

PPL claimed a FTY expense of $2.6 million related to government relations, corporate communications (media and public relations), and community and economic development, an 81% increase. I&E initially recommended a reduction of $1.2 million, but reduced that to $620,000 following the Company's explanation that the direct allocation to PPL Electric had changed. However, while I&E accepted the reallocation between direct and indirect costs and assignment of more costs to PPL Electric, the Company failed to substantiate the inordinate 50% increase in the direct reallocation.

I&E accepted that regional directors may at times become involved in service issues. However, PPL provided no evidence connecting community development and government relations and the provision of safe and reliable service. Indeed, both these

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[26] PPL St. 3-R at 5, misstated in PPL's Exceptions as also requiring routine inspections for sedimentation.
[27] I&E R.B. at 26, citing I&E Cross-Examination Ex. 6 at 3.

expenses enhance the corporate brand and overall corporate standing much like marketing and lobbying, which are generally disallowed as regulatory expenses.[28] Moreover, while logic dictated that as the allocation of direct costs rose, the allocation of indirect costs should have decreased since overall expenses rose by less than 1%, they did not. To the contrary, while the direct cost allocation to PPL Electric increased, so, too, did the indirect allocation.[29] The ALJ rightly concluded that "a schedule attached to [PPL's] rebuttal" does not support the increased allocation to the rate regulated entity.[30]

7. **Storm Damage Recovery – Since PPL will not be renewing its affiliated storm insurance, PPL's exception is moot and should be ignored.** (R.D. Pages 34-40; I&E M.B. Pages 28-31; I&E R.B. Pages 42-60)

As part of the settlement of its 2007 rate case, parties agreed to PPL's implementation of a storm damage risk management strategy that included PPL's recovering expenses related to annual storm repairs through a combination of budgeting an amount from rates to cover normal storm damage and through procuring storm insurance from its affiliate, PPL Power Insurance Limited, an offshore subsidiary of PPL Corp. subject to the regulatory jurisdiction of Bermuda, for major storms. Reviewing five years' of data under this strategy, I&E concluded that the Company's purchase of storm insurance from its affiliate proved more advantageous to the Company's affiliate than ratepayers and recommended that PPL be required to discontinue the insurance and instead use a storm reserve account or a storm rider. This strategy, to be implemented prospectively, would allow PPL to recover storm damage expenses while avoiding

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[28] *See Pa. P.U.C. v. Consumers Pennsylvania Water Company – Roaring Creek Division*, Docket No. R-00973869 (Order entered October 14, 1997) (disallowing advertising, lobbying, and marketing expenses enhancing the parent company's corporate image or not being directly beneficial to customers).
[29] *See* I&E St. 2-SR at 17; I&E R.B. at 28-29.
[30] R.D. at 31; I&E Ex. 2, Sch. 13, a PPL discovery response replicated in PPL Rebuttal Ex. DAC-1, Sch. 5.

questionable affiliate transactions. The ALJ agreed.[31] Although not disagreeing conceptually with a rider and accepting the recommendation thus rendering the issue moot, PPL disputes the ALJ's analysis and raises non-record claims allegedly arising as a result of Hurricane Sandy.

Regarding the ALJ's analysis of PPL's affiliated insurance transactions, I&E respectfully submits that PPL's defense of that management strategy raised sufficient credibility concerns to justify the ALJ's conclusion. In disputing I&E's calculation of its budgeted storm costs, PPL accused I&E of double counting the deductible. After I&E proved PPL's claim was mathematically impossible, PPL presented a belated explanation of "an historic 60/40 split" of the deductible's cost. However, PPL admitted during cross examination that this "historic" split was applied for the first time in 2012, casting suspicion on PPL's claim. As the ALJ concluded: "A single year cannot reasonably be characterized as 'historic' and this type of misleading inaccuracy calls into question the credibility of the witness."[32] I&E's analysis also presented what the ALJ characterized as a "mysterious inconsistency" in PPL's storm expense budget.[33] The ALJ also found that PPL delayed inordinately in seeking insurance proceeds from its affiliate, another finding likely influenced by PPL's belated admission that it was merely PPL's practice, and not a policy requirement as PPL had steadfastly claimed, that it submit one annual aggregated claim. Finally, while PPL asserts it included no cost from this delay in its pending rate request, it ignores its own admission that requiring shareholders to cover this expense

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[31] R.D. at 39.
[32] R.D. at 36. *See* I&E R.B. at 34-36.
[33] R.D. at 36; *See* I&E R.B. at 36-38.

pending receipt of insurance proceeds contributes to a lower shareholder return, which in turn provides PPL grounds for filing this rate increase.[34]

For whatever reason,[35] PPL has accepted the recommended rider. PPL's extra-record claim is of no consequence and should be ignored. PPL should be required to meet with advocates and develop a rider within 90 days.

8. Consumer Education Expense – The ALJ correctly determined that PPL's 2008-2012 Consumer Education Plan (CEP) should end and be replaced by more current programs and funding. (R.D. Pages 46-49; I&E M.B. 60-66; I&E R.B. Pages 43-46)

PPL requested continuation of old education and incentive funding plus new funding at a total cost of almost $8 million; OCA recommended continuation of old funding of $5.4 million but no new funding; I&E recommended termination of old funding as scheduled but the addition of new funding of $2.5 million to comply with newer programs and mandates. The ALJ correctly found that I&E best balanced the need to fund Commission mandates while not wasting ratepayer funds on duplicate efforts.

PPL's CEP was implemented to educate consumers about competitive markets, shopping, and reduced consumption through energy efficiency. It was approved at an annual expense of $5.4 million to begin in 2008 and end in 2012. Since 2008, PPL has also implemented newer programs under its Act 129 Energy Efficiency and Conservation (EE&C) Plan and the Commission's Retail Markets Investigation (RMI). I&E opposed continuation of the CEP beyond its 2012 scheduled ending date because the two segments of education that the CEP was originally designed in 2007 to address –

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[34] R.D. at 38-39; I&E M.B. at 44-48; PPL St. 14-RJ at 2; Tr. 193.

[35] While I&E does not contest the request for official notice of Hurricane Sandy, given the factual disputes of record involving PPL's interactions with PPL Power Insurance, I&E believes that PPL's alleged reason for discontinuing the insurance is not an appropriate subject of official notice. Nonetheless, given PPL's agreement to the rider, the issue is, as PPL recognizes, moot and need not be addressed further by the Commission.

shopping and energy efficiency – are now more effectively addressed and funded going forward through PPL's Act 129 Rider and its proposed CER to fund the RMI mandates.

In Exceptions, PPL argues as it did before the Judge that the CEP is complementary to and not duplicative of Act 129 and the RMI, and that the CEP is educational while Act 129 is financial. PPL too broadly distinguishes between "duplicative" and "complementary" and its literary largess comes with a hefty ratepayer price tag. PPL concedes that the CEP educates consumers on "shopping for electricity [and] the importance of energy efficiency and conservation,"[36] the same goals of the Commission's RMI investigation and PPL's newer Act 129 EE&C Plan. Plus despite PPL's assertion otherwise, the Company's Act 129 Plan provides *both* financial incentives as well as education about energy efficiency, rendering the CEP duplicative.[37]

While the specific activities and specific programs may differ, the goals under all these programs are the same: educate customers about shopping and efficiency and provide financial incentives to modify behavior. PPL's 5-year plan and its substantial $5.4 million annual ratepayer cost should be allowed to lapse naturally at the end of 2012 as already approved. PPL's captive customer base is not the source of unlimited funding.

9. **Customer Assistance Programs Expense – The ALJ properly rejected a request to increase the already substantial ratepayer funding of PPL's customer assistance programs.** (R.D. Pages 44-46; I&E M.B. Pages 66-68; I&E R.B. Pages 46-48)

Community on Economic Opportunity (CEO) requests an annual $1.5 million increase in LIURP (WRAP) funding in PPL's triennial customer assistance program. Although I&E agrees that CEO's request can be addressed in this case as the ALJ

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[36] PPL Exceptions at 27.

[37] *See* I&E St. 2-SR at 47-48, citing PPL's *Final Report for Year 2 of PPL Electric Utilities Corporation's Act 129 Plan* at Docket No. M-2009-2093216.

acknowledged,[38] I&E opposes an increase in LIURP funding. CEO relies on its citation to a 44% increase in potentially eligible low-income customers in PPL's territory for the period 2000 to 2008, its claim that funding under PPL's Operation Help runs out before the end of the quarter, and its assertion that PPL's WRAP funding was increased by "only 3%" in the Company's 2011-2013 Universal Service Plan as evidence of the need for additional funding.[39] However, CEO's analysis lacks depth.

When reviewed over the same time period CEO reviewed, growth in mandatory ratepayer funding for universal service has skyrocketed exponentially compared to growth in low income customers. From 2000 to 2010, PPL's ratepayer funding for its OnTrack program grew by **more than 400%** from $9.5 million to $41.2 million; from 2000 to 2008, PPL's ratepayer funding for weatherization increased by **40.35%** from $5.7 million to $8 million. CEO also ignored new ratepayer funding under PPL's Act 129 WRAP program, which is in addition to PPL's existing LIURP. And new Operation Help funds are made available every new quarter. Through 2012, PPL's ratepayers will have been compelled to contribute $75.35 million annually to fund PPL's universal service programs, up by **122% from 2008 through 2011** alone and projected to increase by **145%** through 2014. CEO also failed to consider that factors other than funding affect both need and the ability to deliver services, as landlords for example can prevent tenants' needs from being met despite the availability of funding. PPL's ratepayers should not be required to provide an additional annual $1.5 million in LIURP funding.

C. Rate of Return

10. Return on Equity – The ALJ's 9.68% calculated ROE is supported by applicable case law and evidence of record and

[38] R.D. at 44-45.
[39] CEO Exceptions at 3.

should be adopted without further adjustment. (R.D. Pages 50-94; I&E M.B. Pages 909-123; I&E R.B. Pages 67-96)

PPL complains that the ALJ's recommended return on equity, calculated at 9.68% and adjusted upwards by 6 basis points to 9.74% for a management reward "significantly understates the cost of equity."[40] PPL also complains that the ALJ recommended a DCF calculated result that was "unadjusted . . . without any check on its validity."[41] An appropriate correction to the calculated ROE, PPL contends, would be a 70 basis point boost from PPL witness Moul's "leverage" adjustment for his Electric Distribution Group (EDG) as well as an additional 6 basis point management reward.[42] Alternatively PPL seeks a result using the Risk Premium or CAPM analyses. This is necessary, PPL contends, because Pennsylvania is "at the bottom of the middle range of Commissions in terms of supportiveness to capital markets" and the Commission simply cannot miss this opportunity to send a clear message not only to PPL, but also to the utility industry in Pennsylvania and the markets in general that Pennsylvania is "supportive of investments" and will "meet[] investor expectations."[43]

Splitting the 151 basis point difference between its originally requested 11.25% and the ALJ's recommended 9.74% ROE, PPL extends an apparent compromise, agreeing that an ROE of at least 10.5%, or an additional 76 basis points (equivalent to an additional $15 million to its equity return[44]), would be acceptable. This, apparently to PPL, would satisfy the "central tendency of recent decisions by other regulatory

[40] PPL Exceptions at 4.
[41] PPL Exceptions at 6.
[42] PPL Exceptions at 11-16, 19.
[43] PPL Exceptions at 6.
[44] Using I&E's Table III attached to its Main and Reply Briefs, the $15 million is calculated by substituting 10.5% for the 11.25% in the Company's claimed ROE and multiplying that by the Company's rate base.

commissions,"[45] the ratemaking standard espoused by PPL, or as stated differently by PPL in testimony, the "154 data points" of "recent nationwide trends," a similar and equally meaningless evidentiary standard espoused by PPL in brief.[46] PPL advocates these irrelevant standards despite its recognition that the relevant standard of review is substantial evidence from the "unique facts presented in each proceeding."[47]

The ALJ's 9.68% calculated ROE is supported by the record and should be adopted. For the reasons stated in I&E's Exceptions, PPL's evidence does not support any management bonus. As for PPL's leverage bonus, PPL seeks such a booster not because any so-called "leverage" adjustment is warranted, but because PPL simply dislikes the results of the DCF calculation. However, PPL's criticisms of the calculated 9.68% ROE are refuted by the facts of record, and a leverage booster simply to increase the results of what is otherwise a legitimate calculation is improper. Finally, the reasonableness of the ALJ's recommendation *was* confirmed by I&E's CAPM results.

PPL's claim that the "principal error in the RD is its sole reliance on an unadjusted DCF cost rate [ ] without a check on the reasonableness of the result of that method" misstates the law and the record.[48] As this Commission recently confirmed, although it may review other results as a check, it relies primarily on the DCF:

> Although there are various models used to estimate the cost of equity, the Discounted Cash Flow (DCF) method applied to a barometer group of similar utilities, has historically been the primary determinant utilized by the Commission. The DCF model assumes that the market price of a stock is the present value of the future benefits of holding that stock. These benefits are the future cash flows of holding the stock, *i.e.*, the dividends paid and the proceeds from the ultimate sale of the stock. Because dollars received in the future are worth less than dollars received today, the cash

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[45] PPL Exceptions at 1.
[46] *See* I&E R.B. at 55-57.
[47] PPL Exceptions at 8-9, citing a 1988 Philadelphia Suburban Water Company case.
[48] PPL Exceptions at 4.

> flow must be "discounted" back to the present value at the investor's rate of return.[49]

While the Commission has both criticized and accepted other methods while reviewing the reasonableness of the DCF results, the DCF has always been the primary standard.[50] The ALJ's recommended 9.68% calculated ROE is not erroneous as a matter of law on the basis that it relied primarily on the DCF.

While not specifically cited in the Recommended Decision, the reasonableness of the ALJ's recommendation was confirmed by I&E's two CAPM analyses, historic and forecasted, which covered comprehensive time periods. The 8.68% simple average of I&E's CAPM studies, employing the same simple averaging PPL witness Moul undertook of his four DCF, CAPM, RP, and Comparable Earnings (CE) calculations, confirmed the reasonableness of I&E's DCF return of 8.38%. Also, because the ALJ used the calculated DCF growth rate *prior* to I&E witness Sears' log linear regression analysis, the ALJ's recommended 9.68% calculated ROE is substantially higher than the 8.68% check provided by I&E's CAPM methodologies. Indeed, at 9.68%, the ALJ's calculated ROE is identical to the average of PPL's own calculated DCF rates for its EDG and IEG

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[49] *Pa. P.U.C. et al. v. City of Lancaster – Bureau of Water, Docket No. R-2010-2179103 (Order entered July 14, 2011)* ("*City of Lancaster – 2011*"), Slip Opinion at 56. For the Commission's long history relying primarily on the DCF methodology, see also *Pa. P.U.C. v. PECO Energy Co.*, 87 Pa P.U.C. 184, 212 (1997) ; *Pa. P.U.C. v. Consumers Pennsylvania Water Company – Roaring Creek Division*, 87 Pa. P.U.C. 826 (1997); *Pa. P.U.C. v. City of Bethlehem*, 84 Pa. P.U.C. 275, 304-05 (1995); *Pa. P.U.C. v. Media Borough*, 77 Pa. P.U.C. 446, 481 (1992); *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, 71 Pa. P.U.C. 593, 623-32 (1989); *Pa. P.U.C. v. Western Pennsylvania Water Co.*, 67 Pa. P.U.C. 529, 559-70 (1988); *Pa. P.U.C. v. West Penn Power Company*, 59 Pa. P.U.C. 552, 600 (1985), *citing inter alia Pa. P.U.C. v. Pennsylvania Power & Light Company*, 76 P.U.R. 4th 30, 59 Pa. P.U.C. 332 (1985).

[50] *See Pa. P.U.C. v. City of Lancaster*, 93 Pa. P.U.C. 120 (1999) ("*City of Lancaster – 1999*"); *Pa. P.U.C. v. Pennsylvania-American Water Company*, 85 Pa. P.U.C. 13 (1995) (wherein the Commission expressed its preference for the DCF while criticizing the Capital Asset Pricing Model (CAPM) and Risk Premium (RP) approaches); *but see PPL 2004 Base Rate Case*, 2004 WL 3119796 at *35 (wherein the Commission relied primarily on the DCF methodology but also used the results of the CAPM and RP "as a check of the reasonableness of our DCF calculation").

groups of 9.67% and 9.69%.[51] By not using I&E's log linear regression analysis, the ALJ's DCF also eliminates one of PPL's three criticisms of I&E's DCF calculations. Thus I&E's CAPM analyses provide a reasonable check on the ALJ's DCF.[52]

PPL's criticism that the ALJ's calculated ROE errs by not accepting the leverage adjustment likewise does not invalidate the R.D. because the leverage adjustment is wholly discretionary and in this case fundamentally unnecessary. Perennially providing this Commission a broad à la carte choice of equity boosters from which to choose in order to enhance results it dislikes, PPL pushes its leverage adjustment to boost the ALJ's DCF calculation. This adjustment is unnecessary not only for the reasons directly noted by the ALJ,[53] but also because Mr. Moul's inputs into his 9.68% DCF calculation are already overstated. Further, today's investment market does not support PPL's ROE.

Both PPL's calculated growth and dividend rates within its DCF analysis already provide the equity boost that PPL seeks through its leverage adjustment. As I&E demonstrated, PPL witness Moul's 5% growth rate was based on his average barometer group growth rates. However, Mr. Moul's barometer groups were flawed in that they did not satisfy even his own criteria. Two of his selected distribution companies had been the

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[51] R.D. at 70.

[52] R.D. at 80. The fact that the ALJ did not specifically note use of the results of the CAPM does not mean it did not otherwise confirm the reasonableness of her DCF recommendation. Further, while PPL complains that the ALJ disregarded its CAPM and RP calculations, PPL's CAPM contained inflated *betas*. I&E M.B. at 94. Moreover, it is undisputed on the record that the CAPM and RP approaches are very similar, with the RP being a simplified version of the CAPM, or its "evil clone," as characterized by the author of an article relied upon by PPL witness Moul. I&E Cross-Examination Ex. 1; Tr. 222-23. Thus, the RP did not need to be considered separately. Even if it were, however, as I&E noted, PPL's RP analysis excluded any data beyond 2007, including the Lehman bankruptcy and 2008 economic crisis that still ensnares the economy. If updated to address the most current data, PPL's RP result is 9.78%, almost on point to the ALJ's recommended 9.68% calculated ROE. I&E St. 1 at 52-53.

[53] R.D. at 68-76. *See also* I&E M.B. at 95-101; I&E R.B. at 75-83. Summarily, Mr. Moul's "leverage booster" has no support in either the ratemaking process or the financial literature, and both Mr. Moul's and the Company's use of it is inconsistent. While both PPL and Mr. Moul claimed that the booster is *not* a market-to-book adjustment, in fact both have described it precisely that way. Compare PPL Exceptions at 15, note 7 and I&E R.B. at 80, particularly notes 204 and 205.

subjects of announced mergers, thus their growth rates were artificially inflated. Also, his Integrated Electric Group included companies that were not similar in business risk, again overstating growth rates. Thus, though accepting I&E's unadjusted (without the log linear regression) growth rate of 4.79%, the ALJ nonetheless arrived at a calculated return on equity of 9.68%, the same DCF return calculated by PPL witness Moul using inflated growth rates. Moreover, the "high end growth rate" accepted by the Commission in PPL's 2004 base rate case is not supported by market conditions today. In 2004, there was still uncertainty surrounding stand-alone distribution companies. As even PPL Corp. today views the rate-regulated EDC business line as valuable stable and reliable revenue source, a high end growth rate to compensate for risk is not supported.[54] Finally, Mr. Moul's dividend yield contained an "ex-dividend adjustment" that lacks academic and financial industry support.[55] Because Mr. Moul's DCF calculation already has inflated inputs, a further upward boost from the "leverage" adjustment is unnecessary.

More importantly, however, PPL's insistence on arriving at a ROE number that satisfies the a "central tendency of other commissions," a "nationwide trend," or is "mainstream,"[56] wholly misses the point of calculating a return on an evidentiary record. The ROE awarded should be grounded in facts specific to the company, barometer groups of similar companies, and other evidence presented in the proceeding. Other returns, at other points in time, for other companies, in other places are irrelevant. Yet, throughout its advocacy, PPL repeatedly cites to other awarded returns on equity to support its (now) claimed 10.5%. However, PPL is totally indiscriminate in its choices.[57]

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[54] I&E R.B. at 74-75.
[55] I&E M.B. at 93-94.
[56] PPL Exceptions at 20.
[57] *See e.g.* PPL Exceptions at 7, note 3, and at 17-18, note 8.

For example, PPL recognizes that in the *2008 Aqua* case[58] the Commission rejected the leverage assessment. However, PPL contends that in that case the calculated ROE was 11% and the Commission noted it had previously used the leverage booster in cases where the DCF ROE was no higher than 10.6% including the booster. Thus, PPL concludes, "[i]n 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."[59] The fact that *2008 Aqua* was decided in 2008, before the most severe economic correction on Wall Street since the Great Depression, and that now, four years later, the economy is still suffering recessionary effects seems to be of no import to PPL.

Similarly, *with* its equity booster, PPL's requested ROE of 10.5% is well above the "adder-free" unadjusted 10% equity return determined most recently in the most comparable market conditions in *City of Lancaster – 2011.* It is also higher than the unadjusted 10.1% equity return the Commission found reasonable and appropriate in 2007 when it rejected a financial risk adder for the Met-Ed and Penelec companies,[60] and the adjusted 10.26% equity return the Commission found reasonable and appropriate in 2007 for then-PPL affiliate PPL Gas, having soundly rejected PPL's 11.75% requested equity return as "excessive and unreasonable."[61] Notable as well is that both of these cases were decided in a time when market conditions reflected substantially higher investor expectations than are present today. PPL has not proven on the facts or the law that its leverage equity adder should be adopted in this proceeding.

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[58] *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-00072711 (Order entered July 31, 2008)("*2008 Aqua*").
[59] PPL Exceptions at 13.
[60] *Pa. P.U.C. v. Metropolitan Edison Company et al.*, 2007 WL 496359 (Pa. P.U.C.) (Docket Nos. R-00061366 et al.; Order entered January 11, 2007) at *74.
[61] *Pa. P.U.C. v. PPL Gas Utilities Corporation*, Docket No. R-00061398 (Order entered February 8, 2007), Slip Opinion at 107-08.

While the substantial evidence of record also discredits Mr. Moul's leverage booster, clearly the Commission has both accepted and rejected it in the past. Thus, if despite the ALJ's rejection the Commission nonetheless accepts it as a legitimate adjustment, then I&E respectfully submits that the determinative factor the Commission should consider in evaluating whether or not to adopt the adjustment on this record should be *realistic* expectations of utility stock returns based upon current market conditions and not *unrealistic* investor expectations predicated on the false notion that utility returns must achieve some predetermined level or be faulted as "too low." Economic reality should define investors' perceptions not the other way around. The reality today is that the double digit returns for utilities should not be presumed.[62]

Insisting this case is a referendum of the level of this Commission's regulatory support to the investment community, however, PPL obscures any meaningful standard of review. Rate of return is a fact-specific determination. Substantive findings must be based upon the case-specific evidentiary record developed in this proceeding. The evidence must be substantial, relevant, and material to PPL in this jurisdiction. In other words, this case is a bellwether for PPL – no more – and must establish an appropriate rate of return for PPL today based upon the evidence available today.

The evidence does not support the perfunctory delivery of double-digit returns. Though the equity market for utilities has changed, PPL witness Moul admitted he consistently recommends ROEs of 11% to 12% as if stuck in a time-warp.[63] Moreover, today reconcilable riders predominate, utility revenues are very stable, and the

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[62] For unrealistic investor expectations, see PPL Exceptions at 18, citing the opinion of inveterate Wall Street advisor and PPL witness Julie Cannell. As I&E noted before the ALJ, Ms. Cannell's contribution to the proceeding was essentially the simple syllogism that because all investors want high returns, and PPL has investors, therefore PPL should be awarded high returns. I&E R. B at 70-71.

[63] *See* Tr. at 222-23, 237-39.

opportunity to earn a return is more assured. PPL has identified no less than five new riders (excluding STAS), some providing the Company interest at attractive rates,[64] that encompass nearly 50% of revenues and costs that, absent the rider, would be included in base rates. And in this proceeding, PPL has not only proposed a sixth new rider (the CER, with interest[65]) but also requested unprecedented increases to its customer charges and will have a storm rider, all of which secure even more certainty to its revenue recovery. Yet, in continuing a consistent request for above 11% returns, Mr. Moul had no idea how many riders PPL implemented,[66] gave no consideration to the proposed rate design, and all but dismissed the DSIC. Mr. Moul's calculations and menu of equity boosters are remnants of a different era and should be relegated to ratemaking history. PPL's ratepayers should be relieved from the responsibility of being the primary source of "stability and security to PPL Corp.'s earnings forecasts and its dividends." While PPL's ratepayers have contributed to uninterrupted dividends to PPL Corp.'s shareholders for 65 years, with PPL Corp. increasing dividends in 7 out of 8 years since 2005 and earning 17.5% returns in 2011 alone, the economy and ratepayers today continue to struggle.

The ALJ's recommendation comports with not only Commission precedent but also market and industry reality. The ALJ's recommendation is not an outlier and should be adopted as an accurate predictor of the utility investment community's new normal.

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[64] I&E Cross-Examination Ex. 11; *See e.g.* PPL's USR and GSC riders, PPL Ex. DAK-1 at Tenth Revised Page No. 18 (USR) ("Interest on overcollections and undercollections shall be computed monthly at the appropriate rate, as provided for in Section 1308(d) of the Public Utility Code[.]"), PPL Ex. DAK-1 at Ninth Revised Page No. 19Z.5 (GSC-1) ("Interest on recoveries of under collections shall be calculated at the legal rate of interest.").

[65] PPL Ex. DAK-1 at Original Page No. 19A.15 ("Interest on overcollections and undercollections shall be computed monthly at the appropriate rate, as provided for in Section 1308(d) of the Public Utility Code[.]").

[66] Tr. at 227.

D. Taxes

11. Gross Receipts Tax – The ALJ's recommendation allows the Company to recover its gross receipts tax in full. (R.D. Pages 94-97; I&E M.B. Pages 68-71; I&E R.B. Pages 48-51)

The ALJ correctly found that the Dept. of Revenue Tax Bulletin confirmed I&E's adjustment to PPL's GRT claim on the basis that PPL's tax liability, even on an accrual basis, is *net of uncollectibles*.[67] Under the express terms of the accrual methodology, one of several options available in the Bulletin, PPL will deduct from its accrued billed revenues accounts that are written off.[68] Positing for the first time in Exceptions a hypothetical that attempts to illustrate alleged difficulties in tracking uncollectibles, PPL claims the ALJ "disregards changes in the calculations of gross receipts tax" that make deductions from the GRT for uncollectibles "next to impossible" and the ALJ "fails to recognize the realities of the obstacles that" DOR has imposed.[69] However, PPL proved no obstacles. PPL claimed it would not be able to comply with self-described "onerous documentation requirements" and alleged that supporting a bad debt deduction would require "significant and costly system changes" due to "complexities" and "significant testing and corrective actions" to resolve "potential 'glitches.'"[70] However, PPL provided no evidence – no evidence of cost analyses, no evidence of system testing, no evidence of actual complexities, no evidence of actual glitches – no evidence to support its claim that it cannot distinguish between billed and collected revenues. All PPL posits for the first time in Exceptions is a hypothetical example of a write-off of a CAP customer's arrears.

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[67] R.D. at 97.
[68] *See* I&E Ex. 2-SR, Sch. 1; I&E R.B. 49-51.
[69] PPL Exceptions at 37-39.
[70] I&E R.B. at 50, citing PPL M.B. at 134.

Exceptions are not the appropriate place for PPL to attempt to present facts to support its case. Actual not imagined complexities should have been identified in testimony to be vetted factually. PPL's hypothetical is not even applicable since a CAP customer's arrearages are not written off in uncollectibles expense but rather are built into the arrearage forgiveness component of the CAP program paid by other customers. Absent evidence PPL pays taxes on uncollected revenues and that the cost of avoidance exceeds the benefit, the ALJ was correct and should be affirmed.

III. CONCLUSION

PPL's four alleged grounds to support its $104.6 million rate increase were overstated and unsubstantiated. The Recommended Decision appropriately rejects many expense claims and other financial requests inextricably related to boosting financial returns of PPL's unregulated affiliates at the expense of PPL's captive ratepayers, addressing the gravamen of I&E's concern that the financial needs PPL's corporate family and not the rate-regulated entity PPL Electric were driving this filing. The ALJ's Recommended Decision as modified in I&E's Exceptions should be adopted.

Respectfully submitted,

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Dated: November 19, 2012

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Exceptions** of the Bureau of Investigation & Enforcement upon the persons and in the manner indicated below:

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