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|  | **PENNSYLVANIA****PUBLIC UTILITY COMMISSION****Harrisburg, PA 17105-3265** |  |
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|  | Public Meeting held April 3, 2014 |
| Commissioners Present: |  |
|  |  |
| Robert F. Powelson, Chairman |  |
| John F. Coleman, Jr., Vice Chairman |  |
| James H. Cawley |  |
| Pamela A. Witmer |  |
| Gladys M. Brown |  |
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| Pennsylvania Public Utility Commissionv.PPL Electric Utilities Corporation |  | Docket No.R-2012-2290597 |
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**OPINION AND ORDER**

**BY THE COMMISSION:**

On March 28, 2013, PPL Electric Utilities Corporation (PPL) filed a proposed Storm Damage Expense Rider as Supplement No. 130 to Tariff Electric – Pa. P.U.C. No. 201, to become effective January 1, 2013.

Supplement No. 130 was filed in compliance with the Commission’s Opinion and Order in *Pa. P.U.C. v. PPL Electric Utilities Corporation*, at the above docket, and entered December 28, 2012 (December 2012 Order).

**Background**

The issue of how PPL would recover storm damage expenses arose in the Company’s 2012 base rate case. There, the Bureau of Investigation and Enforcement (I&E) presented testimony opposing PPL’s continued purchase of storm damage insurance from its affiliate, PPL Power Insurance Limited, an offshore subsidiary of PPL’s parent company, PPL Corp. I&E recommended that PPL use reserve accounting with the possibility of a rider funding the reserve as necessary.[[1]](#footnote-1)

The Commission’s December 2012 Order resolving the 2012 base rate case directed PPL to file a tariff rider for storm damage expense recovery within 90 days of the date of entry. In addition, the Commission directed PPL to collaborate with the statutory advocates to discuss the following details of any proposed rider:

1. Provisions for interest on under and over collections;
2. Timing of reconciliation;
3. Reporting of storm damage expenses and revenue for their recovery;
4. Methods for adjusting the annual level of the expense in rates; and
5. Exact categories of storm damage expense that would be subject to the reconciliation.

On January 14, 2013, the Office of Consumer Advocate (OCA) filed a Petition for Reconsideration or Clarification (Petition) of our December 2012 Order. The Petition questioned whether the collaborative also included consideration of a storm damage reserve account as advanced by I&E and adopted by ALJ Colwell in her Recommended Decision (RD). Answers to the Petition were filed by PPL and I&E on January 24, 2013.

The OCA argued that pages 35-38 of the December 2012 Order appeared to overlook the fact that the RD, PPL’s Exceptions, and I&E’s Replies to Exceptions all discussed the possibility of creating a storm damage reserve account, or a rider for future recovery of extraordinary storm damage, and that the discussion was not limited to the creation of a rider for this purpose. According to the OCA, the December 2012 Order adopted the ALJ’s recommendation to implement I&E’s proposal within ninety days of the date of entry of the December 2012 Order. However, the OCA argued that any discussion of a reasonable mechanism for the recovery of storm damage expenses should include all alternatives developed in the record below. That is, any discussion should include the use of a reserve account and not just a tariff rider. Petition at 3‑5.

The I&E Answer to the OCA Petition supported the OCA’s request that the collaborative should include consideration of both a reserve and rider. I&E Answer at 2‑6.

In its Answer, PPL countered that the OCA did not address the issue of storm damage expenses in its testimony, briefs, exceptions or replies to exceptions. PPL claimed that since the OCA did not contend the subject below, the OCA had not met the legal standard for reconsideration of whether the Commission “overlooked” language in the RD and evidence produced by PPL and I&E regarding a storm damage expense reserve account. PPL Answer at 2.

PPL also argued that the OCA was mistaken in claiming that PPL supported the possibility of the creation of a storm damage reserve account for future recovery of extraordinary storm damage. PPL claimed that neither had it supported the creation of a reserve account without tariff provisions for current recovery of storm damage expenses between rate cases, nor suggested limitation to damage from extraordinary storms. PPL Answer at 2-3.

The PPL Answer continued to argue that a tariff rider would be necessary for it to recover storm damage expenses on a current basis, between rate cases, to reconcile storm damage expenses and revenues for that recovery, and for the adjustment of rates based on the annual level of expenses, in compliance with the December 2012 Order. PPL Answer at 3-4.

By Order entered February 28, 2013, the Commission granted the OCA Petition and ordered PPL to include both a storm damage expense rider and a storm damage reserve account as funding mechanisms within the discussions held in the collaborative process (February 2013 Order).

PPL conducted a collaborative with the OCA, the Office of Small Business Advocate (OSBA), and I&E, but it was unfruitful. On March 28, 2013, PPL unilaterally filed a proposed SDER within the time provided in the December 2012 Order. The proposed SDER was filed as Supplement No. 130 to Tariff Electric – Pa. P.U.C. No. 201 (Supplement No. 130) to become effective January 1, 2013. PPL suggested the Commission allow a 20‑day comment period and 15-day reply comment period on its proposed SDER, followed by Commission ruling.

The Commission agreed to the suggested comment and reply comment periods by Secretarial Letter of April 5, 2013. The OCA filed comments on April 18, 2013, urging rejection of the proposed SDER. I&E filed comments on April 18, 2013, requesting approval of a modified SDER. Also on April 18, 2013, PP&L Industrial Customer Alliance (PPLICA) filed comments urging rejection of PPL’s request to establish an SDER.

On May 6, 2013, the OCA and PPLICA filed reply comments urging rejection of the SDER and I&E’s proposed modifications. The OCA further requested full evidentiary hearings on the matter should the Commission entertain any form of ratemaking treatment for PPL’s normal, ongoing storm damage expenses prior to PPL’s next base rate case. OCA Reply Comments at 5. PPL filed timely reply comments requesting approval of the SDER as proposed. The additional comments and replies did not further a consensus regarding the details of the proposed SDER.

Upon review of the Orders and comments, the Commission determined that the open issues were questions of law and policy that did not require evidentiary hearings. Looking to the direction of Commonwealth Court, the Commission noted that “when there are no disputed questions of fact and the issue to be decided is purely one of law or policy, a case may be disposed of without resort to an evidentiary hearing.”[[2]](#footnote-2) Rather, the Commission determined to initiate a “paper hearing” sufficient to protect the due process rights of the participants.[[3]](#footnote-3) The Commission determined that, given the long history of the case the parties had an opportunity to be heard before an ALJ and through the filing of Comments and Reply Comments.

However, in the interest of ensuring a full vetting of all contested legal issues, the Commission determined it prudent to provide additional due process protection in the form of additional Comments to PPL’s proposed SDER within 30 days of entry of an Opinion and Order in the matter, with Reply Comments due 15 days thereafter. The Commission anticipated substantive legal argument on PPL’s proposal, as well as any counter proposals.

An Opinion and Order was entered November 15, 2013 (November 2013 Order). The filing was suspended by operation of law on October 31, 2013, until February 28, 2014, unless permitted by Commission Order to become effective at an earlier date.[[4]](#footnote-4) In that Order, the Commission noted that it would disregard any attempt to re-litigate the appropriateness of allowing an alternative funding mechanism to replace the disallowed storm damage insurance.

On December 16, 2013, PPL, I&E, OCA and PPLICA filed Comments in response to the November 2013 Order. All Parties, including OSBA, filed timely Reply Comments.

The Commission directed the Parties to address specific questions in Comments and Reply Comments, which were attached to the November 2013 Order as Appendix A. We summarize the substantive portions of all these Comments and Reply Comments below.

**PPL Proposal**

The PPL SDER proposes recovery of storm damage expenses outside of its normal base rate proceedings. The proposed SDER is a form of automatic adjustment clause pursuant to Section 1307(a) of the Public Utility Code, 66 Pa. C.S. §1307(a). The proposed SDER would reconcile, on an annual basis, actual storm damage expenses from reportable storms[[5]](#footnote-5) against the $14.7 million presently included in PPL base rates. PPL proposes that it would apply interest equally on under and over recoveries.

The $14.7 million amount awarded to PPL is based upon a study of PPL’s actual storm damage expenses over an extended period of time, and does not include extraordinary storm damage expenses previously or currently amortized in base rates.

Principal components of the SDER as originally proposed by PPL in Supplement No. 130 include:

* There will be no rate changes related to storm damages in 2013.
* The SDER provides for recovery of damage from storms that are reportable under 52 Pa. Code Section 67.1.
* Damage from smaller storms will continue to be recovered through base rates.
* Damages from extraordinary storms prior to 2012 will continue to be recovered through base rates.
* The SDER will recover from or refund to customers, as appropriate, only storm damage expenses that are less than or greater than $14.7 million annually. Base rates prospectively provide for recovery of $14.7 million in reportable storms.
* Costs of major storm events, as defined in 52 Pa. Code Section 57.192, will be amortized over three years in order to mitigate rate volatility.
* Interest will be paid to or recovered from customers on over and under collections and deferred amounts from major storm events at the residential mortgage rate.
* Interim adjustments to the SDER, effective on 30 days-notice, are permitted subject to Commission approval.
* The SDER will not provide for recovery of damages to transmission facilities, which will continue to be recovered through transmission rates.
* Capital expenditures will be included in rate base and recovered through base rates.
* Straight time wages and benefits incurred to repair storm damage will continue to be recovered through base rates.
* SDER revenues and expenses will be reported to the Commission on or before December 30 of each year and will be subject to audit.
* PPL will be permitted to record on its books of account a regulatory asset or liability for amounts that will be recovered or refunded to customers in the future under the SDER.

PPL proposes to recover 2012 expenses from Hurricane Sandy with the SDER. PPL argues that this is in accordance with the requirements of the Commission’s Hurricane Sandy deferral order in *Petition of PPL Electric Utilities Corporation for Authorization to Defer, for Accounting Purposes, Certain Unanticipated Expenses Relating to Storm Damage*, at Docket No. P-2012-2338996 (Deferral Order).[[6]](#footnote-6) PPL states that it is concerned that if it does not claim recovery of Hurricane Sandy expenses in this proceeding, other parties may contend that it waived recovery of these expenses.

In its Comments filed December 16, 2013, the following modifications to the SDER were proposed by PPL in response to issues that were raised in the November 2013 Order:

**Reconciliation period** – PPL initially proposed a recovery period for the SDER of January 1 through December 31, based on a reconciliation of storm damage expenses from the 12 month period ending December 31 of each year. This would have included an estimate for December. In order to address the concern of using estimated storm damage expenses, PPL then proposed to modify the reconciliation from the 12 month period ending December 31 to the 12 month period ending November 30 of each year (December 1 through November 30).

**Estimated damage expenses** – PPL initially proposed that the SDER would allow for estimates to be used for expenses that may not be known until after the filing date due to the lag in reporting of expenses caused by the use of subcontractors and personnel from other electric distribution companies. In order to address the concern of using estimated storm damage expenses, PPL then proposed to recover only actual, experienced storm damage expenses. Any lag in known expenses beyond the 12 month period ending November 30 of each year would be carried over to the subsequent year(s) in which the actual, total expense becomes known.

**Recovery Period** – PPL initially proposed that it would recover expenses from major storm events, as defined in 52 Pa. Code Section 57.192, over three years with interest. PPL then modified that proposal to allow it to recover all actual, experienced reportable storm damage expenses over a 12 month period (including reconciliation), with the discretion to propose a longer period if necessary or appropriate.[[7]](#footnote-7) PPL argues that large storms would not have a material impact on customer rates, and one-year recovery limits interest expense/credits.

**Interest Calculation** – PPL initially proposed that interest would be paid to or recovered from customers on over and under collections of storm damage expenses at the residential mortgage rate, as published by the Secretary of Banking. For clarification, PPL then modified the proposal to include that interest will be calculated based on the net difference of the amount collected under the SDER and the $14.7 million included in base rates.

**Interim changes to the SDER** - PPL initially proposed that interim changes to the SDER would become effective on 30 days-notice. In order to be consistent with other Commission approved tariff provisions, PPL then proposed to be permitted to make interim changes to the SDER upon 10 days-notice, unless otherwise ordered by the Commission.

PPL maintains that the Commission’s November 2013 Order has already determined that an alternative funding mechanism to replace its discontinued storm damage insurance is appropriate, and therefore, all Comments of the other parties to reject an alternative funding mechanism should be disregarded. PPL Reply Comments at 2.

**I&E Position**

I&E points out that in the 2012 PPL base rate case, I&E Witness Morrissey recommended that PPL use a storm damage reserve account to effectively accrue a budgeted storm damage cushion that would subsequently be offset by experienced storm costs. I&E proposed to calculate the reserve at an annual budget amount to reflect a 5 year average of storm damage expenses. I&E Comments at 4. I&E opposes the use of a traditional 1307(e) tariff rider, and presented a redlined version of Supplement No. 130 designed to effectuate the benefits of its proposed reserve accounting, with rider funding if necessary. In its Comments in response to the November 2013 Order, I&E argues that reserve accounting is successfully used in other jurisdictions. I&E Comments at 7.

I&E also requests that the Commission defer consideration of this matter until PPL’s next base rate case. I&E believes that recovery of storm damage expenses through a 1307(e) rider is neither legally sound nor good public policy. I&E Comments at 8.

**OCA Position**

The OCA submits that the SDER violates prohibitions on single issue ratemaking and lacks proper differentiation of storms and storm damage expenses. The OCA avers that the SDER is not necessary for collection of storm damage expenses, and is contrary to sound ratemaking principles and public policy. OCA Comments at 10.

Like I&E, the OCA requests that the Commission defer consideration of this matter until PPL’s next base rate case. The OCA further requests that, should the Commission determine that action must be taken before PPL’s next base rate case, PPL should use reserve accounting until the matter is considered in the next PPL base rate case.

**PPLICA Position**

PPLICA recommends that the Commission deny the SDER proposal and alternatively requests a funding mechanism limited to a reserve account. PPLICA agrees with the OCA that the Commission should consider a traditional expense deferral process (PPLICA Reply Comments at 2). PPLICA argues that with traditional expense deferral, PPL could request authority to defer any storm damage expenses in excess of $14.7 million for recovery in its next base rate case.

PPLICA agrees with I&E and the OCA that the next PPL base rate case is the appropriate forum to consider such a rider or other alternative. PPLICA Reply Comments at 3. PPLICA points out that the SDER was not subject to evidentiary hearings in PPL’s 2012 base rate case. PPLICA Reply Comments at 4.

PPLICA concludes that according to its analysis, storm damage expenses don’t pass the test for recovery through Section 1307(a). Of main concern to PPLICA is the legality of recovering such expenses in this manner. PPLICA Reply Comments at 4-6.

**OSBA Position**

The OSBA agrees with I&E that reserve accounting is superior to a reconciliation mechanism in handling storm damage expenses. OSBA Reply Comments at 3.

**Financial Analysis**

In this Order, we consider data adjudicated in the PPL 2012 base rate proceeding. In its 2012 base rate filing PPL claimed storm damage expense comprised of (1) a future test year budget for normal storm damage expenses of $12,625,000; (2) the premium for storm damage insurance of $8,750,000; and (3) a proposal to amortize over five years the extraordinary storm expenses in excess of insurance recoveries incurred during major storms in August 2011 (Hurricane Irene) and October 2011 at $5,324,000 per year for five years. ALJ RD at 34; PPL MB at 48. Therefore, total cost recovery for storm damage expense in base rates would total $26,699,000; without insurance premiums total storm damage expense totaled $17,949,000.

The amount budgeted for normal storm damage expense included $3,175,000 of non-reportable storms not covered by insurance and $9,450,000 for reportable storms for expense not covered under the insurance policy. ALJ RD at 35.

The proposed storm damage insurance premium amount of $8,750,000 purchased $18,250,000 of coverage and was subject to an annual deductible of $15,750,000. ALJ RD at 35. The ALJ approved the proposed insurance premium in the RD.

In 2011, PPL petitioned the Commission to defer the extraordinary storm damage that occurred in that year. See P‑2011‑2270396 and P‑2011‑2274298. PPL sought, and the ALJ approved, the amortization of the extraordinary storm damage expense of $26,324,000 over a five-year period for an annual expense of $5,324,000.

In its exceptions PPL informed the Commission that, due to damage caused by Hurricane Sandy, storm damage insurance currently in effect would not be available after December 31, 2012. PPL Exceptions at 21. As such, PPL proposed, and the Commission granted, an additional recovery of $5.25 million, which is the amount of the insurance premium allocable to operating expenses. The December 2012 Order approved the $5.25 million based on an allocation of 60% for operating expenses and 40% for capital costs, i.e., 60% of $8.75 million is $5.25 million. Consequently, operating expenses related to storm damage were reduced by $3.5 million. Therefore, total storm damage related operating expenses for base rate case recovery totaled $23,199,000.

The $23,199,000 in total storm damage operating expenses approved for recovery in the base rate case consists of:

1. $3,175,000 in non-reportable storm damage expense
2. $9,450,000 in PUC-reportable storm damage expense
3. $5,250,000 portion of insurance premium allocable to operating expense
4. $5,324,000 amortization of 2011 extraordinary storm damage expense

PPL proposes that approximately $14.7 million of these costs relates to PUC-reportable storm damage.That $14.7 million is comprised of item 2) the $9,450,000 for reportable storm expense not covered under the insurance policy, and item 3) the $5,250,000 of insurance premiums allocable to operating expenses. PPL’s SDER proposal is to recover or refund to customers the applicable storm damage expenses that are less than or greater than the annual $14.7 million provided for in base rates.

PPL proposes to recover and reconcile Commission-reportable actual incurred storm damage expenses over a twelve-month period, with the exception of the expenses related to damage incurred by Hurricane Sandy. PPL is proposing to recover those expenses over a 3-year period commencing in January 2015. In its deferral petition for storm damages from Hurricane Sandy, PPL estimated that the total storm damage related to Hurricane Sandy would exceed $60 million. Deferral Petition at 4. Further, PPL estimated that after excluding transmission expense, straight time wages, capital cost and the portion of expenses covered by storm insurance, net distribution related storm damage expense to be deferred would be $20 to $30 million. If PPL were to amortize these expenses over a 3 year period, annual storm damage expense related to Hurricane Sandy would be in the range of $6.7 to $10 million per year.



**Legal authority**

1. **Introduction**

PPL proposes to use the SDER to alter the statutory provisions governing its storm expense recovery. Approval of the SDER, as proposed, would shift governance of that recovery from 66 Pa. C.S. Section 1308(d) *General rate increases* to 66 Pa. C.S. Section 1307 *Sliding scale of rates; adjustments*. This Commission recognizes storm damage expenses as a recoverable cost of delivering electric service. There can be little reasonable debate over the fact that the Commonwealth has, as of late, experienced weather phenomena of increased frequency, power, and duration. Regardless of cause, the Public Utility Commission must deal with the undeniable effects of powerful adverse weather events to discharge its statutory role of protecting the public interest in utility matters. Appropriate direction regarding the handling of expenses generated by these weather events is crucial to that role.

The Commission has granted petitions to defer storm damage expenses in recognition of the fact that this reasonable and prudent category of expense might evade legitimate recovery under typical ratemaking practices. This potential exists because utilities are typically at risk for non-capital cost swings between rate cases; actual storm damage expenses may occur outside the historical test year. Similarly, projecting the vagaries of weather in a future test year is fraught with the potential for error: utilities may recover too much too soon or too little, too late. As a protective due process measure, each approved deferral carries the condition that the prudence of storm-related spending is subject to review in a subsequent base rate case. In addition, deferrals work to delay base rate filings as the availability of deferrals allows flexibility in rate case timing – utilities need not rush to file a rate case for fear of these otherwise legitimate expenses falling outside the historical test year. The Commission has had no desire to allow reticence to issue appropriate deferrals to cause increased rate case frequency to become the default tool to manage storm expenses. The availability of deferrals, however, is not the endpoint of Commission consideration of this matter.

The PPL proposed alternative to the traditional deferral mechanism has come under criticism because deferrals are now the accepted ratemaking tool to manage storm damage expenses. The flaw of this general critique is self-evident on close examination: not all traditional tools best serve modern problems. That is, the deferral mechanism does not encompass the full scope of the circumstances under which PPL now seeks relief under Section 1307 of the Public Utility Code.

In the past, utilities were able to use a combination of insurance coverage and deferrals to manage the risks imposed by storm damage. Large, unpredictable storm damage expenses did not imperil utility earnings because insurance payments provided cash flow relief between rate cases. The availability of deferrals then provided the utility with the opportunity to address its prudent storm damage expenses in subsequent rate proceedings. Removing insurance coverage from this process unbalances this traditional ratemaking equation. The unavailability of reasonable insurance coverage is the circumstance addressed by the proposed SDER.

From the PPL 2012 rate proceeding, we now know that insurance providers are displaying increased apprehension to insure against weather-related losses that, as of late, migrate from the category of mitigated risk to expected loss. Storm damage is a very real cost of providing electric service. The experience of weather phenomena of increased frequency, power, and duration will undoubtedly drive increased expense regardless of which solution proves most effective. For example, reliability solutions like infrastructure hardening (rate base issue) or enhanced storm response (expense issue) each carry complex and competing rate implications that may never be fully resolved. For all the above reasons, it is both appropriate and timely for the Commission to consider all alternative storm expense management tools, including proposals like the SDER as a part of its statutory mandate to ensure that utilities provide adequate, efficient, safe and reasonably continuous utility service at just and reasonable rates. 66 Pa. C.S. § 1501.

**2. Expense recovery options under Sections 1307 and 1308 of the Public Utility Code**

While the General Assembly has authorized utilities to request CAPEX and O&M recovery through rates set under the general ratemaking authority of Section 1308 of the Public Utility Code, it has also authorized the recovery of certain categories of expenses through adjustable rates or “surcharges” under Section 1307. A surcharge is an additional billed amount established outside of a Section 1308 ratemaking. Utilities impose Section 1307 surcharges by approved tariff and allow for the recovery of these expenses without including any profit or other recovery. *Popowsky v. Pa. PUC*, 13 A.3d 583 (Pa. Commw. Ct. 2011)(*Newtown*) The burden of establishing the need for, and reasonableness of, any Section 1307 surcharge rests with the public utility. 66 Pa. C.S. § 315.

The issue here is this: does Section 1307 permit PPL to request a surcharge rate to recover storm damage expenses that are otherwise above-the-line? Similarly, does the Commission have authority to consider and, under the appropriate evidentiary showing, approve such an adjustable rate mechanism under Section 1307? Regarding the latter, while Storm damage expenses do not appear within the category of expenses ordinarily allowed under Section 1307, that is not the end of the inquiry. Commission authority to approve a proposed Section 1307 automatic adjustment surcharge is not dependent on that surcharge falling into one of the discrete categories enumerated in that Section. *Newtown* at 591.

1. **Expense recovery under Section 1307**

The guiding principle of any adjustable rate approved under Section 1307, in addition to its being in the public interest, is that it comply with the just and reasonable mandate of 66 Pa. C.S. Section 1301. To do this, we balance the potential benefits that may accrue from the SDER against any potential negative effects. However, unlike the general public interest requirements of Section 1301, Section 1307 specifically seeks to ensure that qualifying rates provide *utilities* with the opportunity to achieve a just and reasonable return. Thus, a primary purpose of Section 1307 is to provide qualified adjustable rate relief to utilities that may be subject to significant expense swings. In many ways, the flexibility of rates set pursuant to Section 1307 serve as a relief valve to fixed rates set under Section 1308. However, while available to utilities, Section 1307 is not the preferred ratemaking methodology. It has limited application and the Commission does not use it to disassemble the traditional ratemaking process of Section 1308.

It is worth noting that the language of Section 1307(a) requires an equitable or reasonable basis for a surcharge to provide a just and reasonable return on the rate base of the utility. As such, a non-statutory Section 1307 surcharge must address a significant expense. That is, the requested recovery must represent an expense capable of substantially degrading a utility’s reasonable return on rate base. Section 1307 surcharges are not favored and utilities should not turn to Section 1307 as a cure for all revenue-related ills. The Commonwealth Court has been clear that “the PUC should not use it [Section 1307] to disassemble the traditional rate-making process.” *Newtown* at 589.

The limitations on rates set under Section 1307 include the prohibition on the recovery of capital expenses via surcharges -- inasmuch as Section 1311 of the Public Utility Code prevents utilities from recovering capital expenses by surcharge because of the used and useful principle. Absent statutory authorization, CAPEX recovery is appropriate only within the confines of a utility’s rate base and not through a Section 1307 surcharge mechanism. *Newtown* at 590. Also, the adjustable expense recovery permitted under Section 1307 is limited to those expenses expressly authorized, or those easily identifiable, variable and beyond a utility's control – examples of the former include costs for fuels, the latter, taxes and purchased water. *Newtown* at 591. At the same time, it should be noted here that in the wake of electric and natural gas restructuring, the Commission has approved a host of automatic adjustment clauses for Electric Distribution Companies and Natural Gas Distribution Companies to recover, for example, default service expenses, transmission expenses, gas procurement charge, universal service expenses, smart meter deployment expenses and energy efficiency and conservation program expenses. Thus, the scope of expenses recovered via Section 1307 has expanded in recent years.

Nevertheless, a fundamental difference between Section 1308 and Section 1307 is that under Section 1308, an increase in rates in excess of 3% of total gross intrastate revenues affecting more than 5% of customers is subject to a mandatory 7 month suspension period and Commission investigation as to the justness and reasonableness of the proposed increase, unless the Commission votes affirmatively to allow the increase to become effective pending investigation. 66 Pa. C.S. § 1308(d). This statutory mandate suggests that increases in excess of 3% via a Section 1307 surcharge for expenses ordinarily accounted for in base rates may be beyond the intended scope of Section 1307. In addition, a surcharge for a given category of expense may not be sustainable as both a Section 1307 surcharge and as a Section 1308 base rate; accepted ratemaking principles do not permit any duplicate recovery. Utilities utilizing these types of surcharges have been required to roll the surcharge into base rates, setting a $0 surcharge with the creation of new base rates. *Newtown* at 592.

Finally, unlike Section 1308 rates, all Section 1307 adjustable rates are subject to over-and-under reconciliation mechanisms that provide for the fundamental requirement that Section 1307 rates are just and reasonable. [[8]](#footnote-8) Section 1307 is unambiguous regarding reconciliation. Reconciliation mechanisms adjust for the difference between surcharge revenues received and expenses incurred within the reconciliation period. In addition, Section 1307 does not accommodate forecasted or estimated expenses. All Section 1307(e) rates and reconciliations approved by this Commission must comply with this statutory directive. Reconciliation proceedings also impute interest on over collections. While the function of a Section 1307 adjustable rate is to permit rapid recovery of a discrete expense item, a comprehensive analysis upon reconciliation of actual costs with previously projected costs used to establish the effective rate is also required. *Newtown* at 591 *quoting* *Masthope Rapids Property Owners Council v. Pa. PUC*, 581 A.2d 994, 1000 (Pa. Commw. 1990).

1. **Approval of non-statutory surcharges under Section 1307**

In summary, the utility requesting a non-statutory Section 1307 surcharge bears the burden to show all the following regarding its request:

1) The surcharge is a valid above-the-line expense

2) The expense in question is capable of degrading utility return on rate base to a significant degree

3) The expense is capable of evading recovery in a prospective Section 1308 base rate proceeding

4) The surcharge will not recover capital costs, i.e., it is a pure expense

5) The expense is discrete and easily identified

6) The expense is variable and beyond the utility’s control

7) The annual reconciliation procedure is adequate

8) The surcharge will reset to $0 at each base rate proceeding or use other mechanisms to prevent double recovery

As filed, the PPL SDER fails to meet some of these requirements. However, the modifications imposed below address these shortcomings such that the Commission may conditionally approve the surcharge.

**Disposition**

A public utility has the burden of proof to establish the justness and reasonableness of every new proposed rate. The required standard is set forth in the Public Utility Code (Code) at 66 Pa. C.S. § 315(a):

**Reasonableness of rates.** –In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceeding upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

In rate proceedings, the burden of proof does not shift to parties challenging the rate filing. Rather, the utility’s burden of proof to establish the justness and reasonableness of every component of its rate request is an affirmative one and that the burden of proof remains with the public utility throughout the course of the rate proceeding. Pennsylvania courts have held there is no similar burden placed on other parties to justify a proposed adjustment to the utility’s filing. *Berner v. Pa. PUC*, 382 Pa. 622, 631, 116 A.2d 738, 744 (1955).

Therefore, PPL has the burden of proving that its proposed surcharge is just and reasonable under the Code.

Also, any issue or comment that we do not specifically address has been duly considered and will be denied without further discussion. We are not required to consider, expressly or at length, each contention or argument raised by the parties. *Consolidated Rail Corporation v. Pennsylvania Public Utility Commission*, 625 A.2d 741 (Pa. Cmwlth. 1993); *see also*, *generally*, *University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).

The Commission recognizes that because of insurance difficulties, PPL now requires an alternative mechanism to fund its storm damage expense recovery, and that the Commission implicitly approved the development of an alternative mechanism in its November 2013 Order. [[9]](#footnote-9) We find that the implementation of a SDER is consistent with our prior orders and precedent. Commonwealth Court has stated “[a]s we have previously held, a Section 1307(a) automatic rate adjustment is appropriate where expressly authorized, as in 66 Pa. C.S. § 1307(g), or for easily identified expenses that are beyond a utility’s control such as tax rate changes or changes in the cost of fuel.” *Popowsky v. Pa.P.U.C*., 869 A.2d 1144, 1160 (Pa. Commw. 2005) *appeal denied*, 895 A.2d 552 (Pa. 2006) (*Popowsky*).

We find that the scale and scope of PPL storm damage expenses addressed by the SDER are beyond its control. While the Commission acknowledges commenter opinion that PPL’s response to adverse weather events is within its control, this opinion cannot be reconciled with utility and Commission obligations under Section 1501 of the Public Utility Code. An appropriate utility response to storm events must encompass adequate preparation for storm damage expected and reasonably rapid restoration of storm damage inflicted. Nature is the primary director of the scale and scope of these matters ‒ not utility management.

In addition, storm damage expense is unquestionably an above-the-line expense. Storm damage expenses, properly isolated from costs flowing into base rates, are easily identifiable expenses. The fact that utilities have used storm damage deferrals to the satisfaction of all stakeholders stands testament to this conclusion.

Also, given the evidence adduced in the PPL 2012 base rate case, we conclude that the risk of excessive storm damage expenses in the absence of reasonable insurance coverage represents a significant imposition on the opportunity to earn an approved rate of return absent an additional base rate proceeding. Using data from PPL’s 2012 base rate Order, storm damage costs in the range of $10-$30 million could reduce the allowed rate of return by as much as 25 to 75 basis points. It is very likely that the storms of the winter of 2013/2014 will only exacerbate any such circumstance.

We find that implementation of a SDER will work to provide timely revenue recovery such that PPL will have adequate resources to respond to powerful weather events, and will facilitate more gradual changes in rates in the future. We believe that the benefit of implementing the SDER is particularly appropriate given the size of recent storm events and our increasing emphasis on enhanced system reliability even in the face of these powerful storm events.

Nevertheless, the Commission does not adopt the SDER as filed by PPL despite these acknowledgements and legal conclusions. After reviewing all parties’ comments and reply comments, the Commission approves PPL’s proposed Section 1307 automatic adjustment clause to recover storm damage expense as explained below.

The Commission **approves** these aspects of the PPL SDER as proposed:

* All capital expenditures are excluded from the SDER and can only be recovered through base rates.
* All straight time wages and benefits, or other costs included in base rates, incurred to repair storm damage are excluded from the SDER and can only be recovered through base rates.
* The SDER will not provide for recovery of damages to transmission facilities, which will continue to be recovered through transmission rates.
* There will be no reconciliation between the $14.7 million of storm damage expense recoverable through rates and storm damage incurred in 2013.
* The SDER provides for recovery of damage from storms that are reportable under 52 Pa. Code Section 67.1.
* Extraordinary storm damage expense incurred due to Hurricane Sandy will be recovered over a thirty-six month period commencing with the SDER.
* Damage from smaller non-reportable storms will continue to be recovered through base rates and are not included in the calculation of the SDER.
* Damages from extraordinary storms prior to 2012 will continue to be recovered through base rates. (Base rates already include approximately $5.3 million of storm damage expense for these deferrals).
* The SDER will recover from customers storm damage expenses that are greater than $14.7 million (net storm damages) annually. Base rates prospectively provide for recovery of $14.7 million in reportable storms.
* If storm damage is less than $14.7 million annually, the SDER will refund to customers the difference between actual storm damage expense and the $14.7 million included in base rates. (Refund or reduce deferral amounts. See Below)
* The SDER will recover only actual, experienced storm damage expenses. Any lag in known expenses beyond the 12 month period ending November 30 of each year will be carried over to the subsequent year(s) in which the actual, total expense becomes known.
* The recovery period for the SDER will be January 1 through December 31, and is based on net storm damage expenses for the 12 month period ending one month before the beginning of the recovery period (December 1 through November 30). For reconciliation purposes, SDER revenues and expenses will be reported to the Commission on or before November 30 of each year and will be subject to audit.
* PPL will be permitted to record on its books of account a regulatory asset or liability for amounts that will be recovered or refunded to customers in the future under the SDER.

The Commission approves the SDER subject to the following **modifications**:

* Revenue collected under the SDER shall not exceed three percent (3%) of the total intrastate operating revenues billed to customers, exclusive of amounts recovered under the State Tax Adjustment Surcharge.[[10]](#footnote-10) Amounts exceeding three percent may be deferred. Any deferred amounts shall be subject to a reasonable amortization schedule.
* Deferred amounts may continue to be recovered through the SDER subject to the 3% intrastate operating revenues limitation, but in no event will the SDER recover expenses beyond an approved amortization period. Deferred but unamortized expenses are subject to recovery in subsequent base rate cases under Section 1308.
* SDER credits (storm damage less than $14.7 million annually) will be applied either as an SDER credit or as an offset to amounts deferred for future collection, as appropriate.
* All actual, experienced reportable storm damage expenses will be recovered and reconciled over a 12 month period **with the exception of storm damage expense related to extraordinary storm damage**. For accounting purposes, the Uniform System of Accounts General Instruction 7 defines an extraordinary item as an item that exceeds five percent (5%) of a utility’s annual net income. Storm damage expense exceeding 5% of the Company’s annual distribution net income will be considered extraordinary for SDER recovery purposes.
* Extraordinary storm damage expense, as defined above, shall be deferred and amortized over a three year period. Future recovery of extraordinary storm damage expense will be handled in a similar fashion as to PPL’s proposed recovery of Hurricane Sandy expenses. Deferred amounts may be recovered in the SDER in accordance with the required 3-year amortization and the 3% SDER cap.
* Interest will be calculated based on the net difference of the amount collected under the SDER and net storm damage expenses to be recovered during the recovery period. PPL explains that interest will be calculated only on the net difference between the amount recovered through the SDER and net storm damage expenses. Interest will be paid to or recovered from customers at the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the Loan Interest and Protection Law (P.L. 13, No. 6). Interest will not accrue on deferred amounts from extraordinary storm events during the deferral period. For example, interest will not accrue on Hurricane Sandy deferral amounts prior to being available for recovery under the SDER.
* Interim changes to the SDER will be permitted upon 30 days-notice as originally proposed, unless otherwise ordered by the Commission.
* PPL shall file a tariff to comply consistent with the Commission’s Order in this matter. PPL shall file the initial tariff with 60 days’ notice to be effective January 1, 2015. The initial compliance tariff for the Company’s SDER will include actual storm cost data, calculation detail and other supporting documentation as to how the SDER was derived. The initial 60 day review period will provide an adequate review period for Commission Staff and other interested parties to conduct a prudency review of the submitted data. Subsequent SDER tariff filings may be submitted on 30 days’ notice.
* Storm damage rider costs shall be allocated among rate classes pursuant to the cost of service study approved by the Commission in the 2012 base rate case. Allocation factors shall be included in the tariff.
* The $14.7 million threshold will be adjusted up or down in each base rate case proceeding, as appropriate, and the SDER will be reset to zero ($0).

PPL’s proposed SDER contemplates the recovery of reportable storm damage expense that exceeds the $14.7 million that is currently being recovered in base rates. Reportable storm damage expense that is recoverable under the SDER will include operations and maintenance expenses, excluding straight time wages and benefits, for damages caused by these storms. Capital costs and damage caused to transmission facilities will also be excluded from recovery under the SDER. The SDER will recover only actual incurred expense; no forecasted or projected expenses will be used.

As noted above, the total Commission-reportable storm damage for recovery in base rates is $14.7 million, which is comprised of the $9,450,000 for reportable storm expense not covered under the insurance policy, and the $5,250,000 of the insurance premium allocable to operating expenses. PPL’s SDER proposal is to recover or refund to customers the applicable storm damage expenses that are less than or greater than the annual $14.7 million provided for in base rates. While not a reserve fund per se, we consider the $14.7 million provided for in base rates to function in a similar manner. An advantage our modification provides over an escalating or capped reserve fund is that ratepayers will experience a rate decrease should there be no requirement to use the $14.7 million in whole or in part within any reconciliation period.

PPL has proposed that, with the exception of storm damage incurred for Hurricane Sandy, recovery of Commission-reportable storm damage expense will occur over a twelve month period. Because PPL has requested, and the Commission has approved, the deferral of storm damage expenses from Hurricane Sandy, PPL is seeking recovery of these costs over a thirty-six month period. The Commission concurs with this proposal with the exception that all reportable storm damage caused by an extraordinary event should be deferred and amortized over a three year period. Storm damage expense exceeding 5% of the Company’s annual distribution net income will be considered extraordinary for SDER recovery purposes. In this way, PPL is complying with accounting guidelines as required by the Federal Energy Regulatory Commission’s Uniform System of Accounts. Additionally, the deferral and amortization is consistent with Commission precedent and will help to minimize any potential rate shock for customers.

PPL proposes a twelve-month collection period from January 1 through December 31. The SDER for this twelve-month period will be based on net storm damage expenses for the previous twelve-month period ending one month before the beginning of the recovery period. Therefore, if the SDER were to be effective January 1, 2015, the SDER would be based upon storm damage expense and revenues from December 1, 2013 through November 30, 2014. Additionally, PPL notes that pursuant to Section 1307(e) of the Public Utility Code, historic SDER revenues will be reported to the Commission on or before December 30 of each year and will be subject to audit and Commission review. Since this proposal is consistent with other automatic adjustment clauses in place today, the Commission concurs with PPL’s proposed recovery and reconciliation period. We believe that with our required modifications, PPL will have sufficient safeguards to protect its customers from unreasonable rate increases.

PPL proposes to allocate storm damage rider costs among rate classes pursuant to the cost of service study approved by the Commission in PPL’s 2012 base rate case. The Commission agrees that allocation using the cost of service study from the approved base rate proceeding is appropriate, and directs PPL to include the allocation factors in its tariff.

PPL had originally proposed that interim changes to the SDER would become effective on 30 days-notice unless otherwise ordered by the Commission. PPL is now proposing that an interim change would be reduced to a 10 day notice stating that this is consistent with other similar Commission approved tariffs. Due to the possible complexity of the review required for an interim change to the SDER, the Commission considers the 10 day notice period inadequate and directs PPL to provide a 30 day notice period for an interim change to the SDER, unless otherwise ordered by the Commission.

PPL will record on its books of account a regulatory asset or liability for amounts that will be recovered or refunded to customers in the future under the SDER. A regulatory asset will be recorded for storm damage expenses exceeding the $14.7 million in base rates, *i.e.*, amounts to be recovered through the SDER. A regulatory liability will be recorded should net storm damage expenses be less than the $14.7 million recovered through base rates. Alternately, a net storm damage credit may be used to offset remaining regulatory asset amounts that arise from deferred extraordinary storm damage expense not yet available for recovery under the SDER.

Total annual revenues collected under the proposed SDER will be capped at an amount not to exceed 3% of the total intrastate operating revenues billed to customers as we discussed above. If storm damage expense available for recovery exceeds 3%, the excess expenses will be deferred and available for recovery in the Company’s next base rate case under Section 1308.

While we do not establish an SDER rate in this Order, we acknowledge the rate effect the SDER may have on ratepayers. By way of example, using results from the 2012 base rate proceeding, if the Commission were to impose a 3% cap of annual intrastate revenue per Section 1308 of the Code similar to what was imposed in *Newtown*, PPL would have a cap of approximately $25.5 million per year of storm damage expense.



Currently, $14.7 million in Commission-reportable storm damage expense is available for recovery through base rates. If and when PPL files its next base rate case, the amount of reportable storm damage expense to be recovered in base rates should be resized to reflect the most recent data of actual reportable storm damage expense. The SDER at this point should be resized to reflect the new amount recovered in base rates and the SDER should be reset to zero.

**Conclusion**

Based on the analysis of PPL’s proposal, filed public comments and applicable law, the Commission finds that the proposed SDER shall be approved subject to the modifications outlined in this Order. Balancing potential benefits that may accrue from the SDER against any potential negative effects we find that the implementation of a SDER is in the public interest and that the SDER, as modified, complies with the requirements of 66 Pa. C.S. Section 1307 and the just and reasonable mandate of 66 Pa. C.S. Section 1301.

 Investigation and analysis of the proposed tariff filing and the supporting data indicate that the proposed changes in rates, rules, and regulations are just, lawful, reasonable, and in the public interest; **THEREFORE,**

**IT IS ORDERED:**

1. That PPL Electric Utilities Corporation’s proposed Storm Damage Expense Rider is approved subject to the modifications outlined in this Order.

2. That the rates, rules and regulations proposed in Supplement No. 130 to Tariff Electric – Pa. P.U.C. No. 201 are rejected, and will not be placed into effect.

 3. That PPL Electric Utilities Corporation shall file a tariff supplement with its initial Storm Damage Expense Rider, as approved and modified by this Order, with 60 days’ notice to be effective January 1, 2015. Subsequent annual and interim changes to the Storm Damage Expense Rider may be filed with 30 days’ notice.

4. That a copy of this Opinion and Order shall be served upon PPL Electric Utilities Corporation, the Bureau of Investigation & Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, and PP&L Industrial Customer Alliance.

 **BY THE COMMISSION,**

 Rosemary Chiavetta

 Secretary

(SEAL)

ORDER ADOPTED: April 3, 2014

ORDER ENTERED: April 3, 2014

1. In her RD, while ALJ Colwell recommended that the Commission direct PPL to develop a plan to establish a storm damage reserve account and to submit that plan for approval, she also approved PPL’s proposed insurance premium costs of $8.75 million for recovery in base rates. RD at 39. [↑](#footnote-ref-1)
2. *Dee Dee Cab, Inc. v. Pa. Pub. Util. Comm’n*, 817 A.2d 593, 598 (Pa. Commw. 1995). *See also, Lehigh Valley Power Committee v. Pa. Pub. Util. Comm’n*, 563 A.2d 548, 556 (Pa. Commw. 1989)(“[i]t is a fundamental proposition of law that a hearing or trial procedure is necessary only to resolve disputed questions of fact and is not required to decide questions of law, policy or discretion.”).  [↑](#footnote-ref-2)
3. *Diamond Energy, Inc. v. Pa. Pub. Util. Comm’n*, 653 A.2d 1360, 1367 (Pa. Commw. 1995)(“based on the absence … of disputed facts, [a] paper hearing … [is] not violative of due process.”). [↑](#footnote-ref-3)
4. PPL proposed charges of zero dollars under the SDER for the period January 1, 2013 through December 31, 2013; however, the Commission concluded that the retroactive effective date of January 1, 2013 in Supplement No. 130 was not in compliance with 66 Pa. C.S. §1308(a), which requires tariff supplements proposing changes in rates to be filed on 60 days-notice. By filing on March 28, 2013, the earliest effective date for the proposed SDER is May 28, 2013. On February 18, 2014, PPL voluntarily further suspended Supplement No. 130 until April 30, 2014, with rates going into effect on May 1, 2014. [↑](#footnote-ref-4)
5. PPL defines reportable storms as “those storms that cause unscheduled service interruptions in a single event for 2,500 or more customers for six or more consecutive hours,” consistent with the Commission’s regulations at 52 Pa. Code § 67.1(b). [↑](#footnote-ref-5)
6. *Petition of PPL Electric Utilities Corporation for Authorization to Defer, for Accounting Purposes, Certain Unanticipated Expenses Relating to Storm Damage*, Docket No. P-2012-2338996, Order Entered February 14, 2013, page 4 states “PPL Electric shall claim the deferred expenses at its first available opportunity.” [↑](#footnote-ref-6)
7. With the exception of storm damage expenses incurred for Hurricane Sandy in October 2012. PPL proposes that these expenses be recovered over a three year period starting with the SDER to become effective January 1, 2015. [↑](#footnote-ref-7)
8. Valid non-statutory surcharges under 66 Pa. C.S. Section 1307 must contain appropriate procedures to determine the reasonableness of those charges as the charges are set outside the base rate procedures of 66 Pa. C.S. Section 1308. As such, Section 1307 surcharges are not Section 1308 rates and are not subject to the general prohibitions applicable to Section 1308 rates, e.g., single-issue ratemaking. *Popowsky v. Pa. PUC*, 13 A.3d 583, 593 (Pa. Commw. Ct. 2011)(*Newtown*).

 [↑](#footnote-ref-8)
9. See the Motion of Chairman Robert F. Powelson at 2: “Additional attempts to relitigate the appropriateness of allowing an alternative funding mechanism to replace the disallowed storm damage insurance will be disregarded.” [↑](#footnote-ref-9)
10. We use the terminology *total gross intrastate operating revenues* to mirror the requirements of 66 Pa. C.S. Section 1308(d). For purposes of the SDER, these revenues are Pennsylvania jurisdictional revenues e.g., distribution including customer service revenue but excluding generation and transmission revenue. [↑](#footnote-ref-10)