

I&E Statement No. 3-SR
Witness: Jeremy B. Hubert

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

METROPOLITAN EDISON COMPANY
Docket No. R-2016-2537349

PENNSYLVANIA ELECTRIC COMPANY
Docket No. R-2016-2537352

PENNSYLVANIA POWER COMPANY
Docket No. R-2016-2537355

WEST PENN POWER COMPANY
Docket No. R-2016-2537359

Surrebuttal Testimony

of

Jeremy B. Hubert

Bureau of Investigation and Enforcement

Concerning:

Residential Customer Cost Analysis
Residential Customer Charges
Revenue Allocation

TABLE OF CONTENTS

INTRODUCTION	1
RESIDENTIAL CUSTOMER COST ANALYSIS	2
RESIDENTIAL CUSTOMER CHARGE RECOMMENDATION	15
REVENUE ALLOCATION.....	16
REVENUE ALLOCATION – MET-ED	26
REVENUE ALLOCATION - PENELEC.....	28
REVENUE ALLOCATION – PENN POWER	29
REVENUE ALLOCATION – WEST PENN	32

1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Jeremy Hubert. My business address is Pennsylvania Public Utility
4 Commission, P.O. Box 3265, Harrisburg, PA 17105-3265.

5
6 **Q. ARE YOU THE SAME JEREMY B. HUBERT WHO SUBMITTED I&E**
7 **STATEMENT NO. 3 AND I&E EXHIBIT NO. 3 ON JULY 22, 2016?**

8 A. Yes.

9
10 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

11 A. The purpose of my surrebuttal testimony is to present a response to the rebuttal
12 testimonies submitted by Kevin M. Siedt and Thomas J. Dolezal on behalf of the
13 four Pennsylvania electric distribution companies (“EDCs”) that are wholly-
14 owned utility subsidiaries of FirstEnergy Corporation (“FirstEnergy”):
15 Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company
16 (“Penelec”), Pennsylvania Power Company (“Penn Power”), and West Penn
17 Power Company (“West Penn”) (collectively referred to as the “Companies”). I
18 will also address portions of rebuttal testimony submitted by Clarence L. Johnson
19 on behalf of the Pennsylvania Office of Consumer Advocate (“OCA”), Brian
20 Kalcic and Robert D. Knecht on behalf of the Pennsylvania Office of Small
21 Business Advocate (“OSBA”), Jeffry Pollock on behalf of Met-Ed Industrial
22 Users Group (“MEIUG”), Penelec Industrial Customer Alliance (“PICA”), and

West Penn Power Industrial Intervenors (“WPPII”), and Richard A. Baudino on behalf of AK Steel Corporation.

I will describe the Bureau of Investigation and Enforcement's (“I&E”) positions concerning the residential customer cost analysis, residential customer charges, revenue allocation based on the cost of service study prepared by the Companies and provide revised revenue allocations based on the Companies’ revised cost of service studies.

RESIDENTIAL CUSTOMER COST ANALYSIS

Q. DID YOU CONDUCT A RESIDENTIAL CUSTOMER COST ANALYSIS FOR EACH OF THE COMPANIES AS PART OF YOUR DIRECT TESTIMONY?

A. Yes. My customer cost calculations are presented on Schedules 6 through 9 of I&E Exhibit No. 3 and are discussed on pages 37-43 of my direct testimony.

Q. WHAT ITEMS DID YOU INCLUDE IN YOUR CUSTOMER COST ANALYSES TO DETERMINE THE APPROPRIATE RESIDENTIAL CUSTOMER CHARGES?

A. I included the following customer costs in my cost analyses:

- Distribution expenses related to the operation and maintenance of meters, supervision & engineering, miscellaneous expenses, and rents;

- Customer accounting expenses related to customer account supervision, collections, percentage of uncollectibles accounts expense that is attributable to the revenue from customer charges, information supervision, information miscellaneous expense, and account payroll;
- Administrative and general expenses related to employee pension and benefits and payroll taxes;
- Depreciation expenses related to services, meters, and office equipment and amortization of smart meters and legacy meters;
- Rate base related return and income taxes related to net services, meters, and office equipment plant, including deductions for customer advances and deposits and a credit for the liberalized depreciation of services, meters, and office equipment; and
- Offsets for reflected other gas revenues and revenues from forfeited discounts.

Q. DID THE COMPANIES ADDRESS YOUR CUSTOMER COST ANALYSES?

A. Yes. The Companies' witness Kevin M. Siedt claims in Met-Ed/Penelec/Penn Power/West Penn Statement No. 3-R, pages 16-19 that my customer cost analyses are flawed because they exclude certain costs that the Commission determined

1 could be recovered in the customer charge in PPL Electric Utility Corporation's
2 ("PPL") 2012 base rate case,¹ such as:

- 3 • Customer-related portions of Account 360 - Land;
- 4 • Customer-related portions of certain general and intangible assets:
 - 5 ▪ Account 303 – Intangible;
 - 6 ▪ Account 390 – Structures;
 - 7 ▪ Account 392 – Transportation;
 - 8 ▪ Account 394 – Tools & Garage Equipment;
 - 9 ▪ Account 397 – Communication Equipment; and
 - 10 ▪ Account 398 – Miscellaneous Equipment.
- 11 • Certain customer service costs:
 - 12 ▪ Account 908 – Customer Assistance Expense; and
 - 13 ▪ Account 909 – Customer Advertising Expense.
- 14 • Customer-based administrative and general costs:
 - 15 ▪ Account 920 – A&G Salaries;
 - 16 ▪ Account 921 – A&G Office Supplies;
 - 17 ▪ Account 923 – A&G Outside Services;
 - 18 ▪ Account 924 – A&G Property Insurance;
 - 19 ▪ Account 925 – A&G Injury and Damages;
 - 20 ▪ Account 928 – Regulatory Commission Expense;

¹ *Pa. P.U.C v. PPL Electric Utility Corp.*, Docket No. R-2012-2290597 (Order entered December 28, 2012).

- Account 930 – General Advertising and Misc. Expense;
 - Account 931 – A&G Miscellaneous Rent; and
 - Account 935 – A&G Maintenance of General Plant.
- A portion of uncollectible accounts expense – Account 904.

Q. WHAT ARE THE COMPANIES' QUALITATIVE REASONS TO SUPPORT HIGHER CUSTOMER CHARGES?

A. The determination and level of customer charges is largely a matter of regulatory policy. Many jurisdictions have a policy of maintaining minimal fixed charges for public utility services, while some jurisdictions have moved to straight-fixed variable pricing, wherein all distribution service is collected from fixed charges. In this instance, the Companies justify inclusion of the costs to be recovered in their customer cost analyses by relying upon the approach that PPL took in its 2012 base rate case.

Q. WHAT HAS THE COMMISSION PREVIOUSLY SAID REGARDING CUSTOMER FIXED CHARGES?

A. The Commission has a long standing history of relying on the basic customer method to determine the customer fixed charge. This method only includes costs directly related to the number of customers in a customer fixed charge. As referenced by OCA witness Clarence L. Johnson (OCA Statement No. 3-R, p. 17),

1 in its October 14, 2011 Columbia Gas rate case Opinion and Order,² the
2 Commission adopted the presiding ALJ's Recommended Decision. The Opinion
3 and Order stated:

4 The ALJ found that the Company's LDC proposed rate design to
5 eliminate the volumetric distribution usage charge and force all
6 residential ratepayers to pay a fixed monthly customer charge, which
7 would recover all base rate costs except universal service program
8 costs, is unreasonable, contrary to sound ratemaking principles,
9 inconsistent with Commission precedent and contrary to the public
10 interest. R.D. at 96. Further, the ALJ stated that Commission
11 precedent consistently limits fixed customer charges to direct costs
12 only, such as the cost to hook up and to maintain a customer's
13 account. Id. Consequently, the ALJ found that the Company did not
14 carry its burden of proof on this issue and thus recommended that
15 Columbia's LDC rate design be rejected. Id.
16

17 Mr. Johnson's analysis also relies upon the Commission's expressed preference
18 for the basic customer cost method for determining customer fixed charges in the
19 1985 and 1990 West Penn Power base rate cases (OCA St. No. 3, p. 39).
20

21 **Q. DOES MR. JOHNSON'S CUSTOMER COST ANALYSES ADHERE TO**
22 **PRIOR COMMISSION PRECEDENT REGARDING THE COSTS**
23 **APPROPRIATELY RECOVERABLE THROUGH A CUSTOMER**
24 **CHARGE?**

² *Pa. P.U.C., et al. v. Columbia Gas of Pennsylvania, Inc.*, Opinion and Order at Docket Nos. R-2010-2215623 and R-2010-2201974 (Issued October 14, 2011).

1 A. Yes. However, in PPL's 2012 base rate case, the Commission approved a slightly
2 modified method to determine the appropriate costs recoverable through a
3 customer charge, the Aqua method.

4
5 **Q. WHAT IS THE AQUA METHOD?**

6 A. The Aqua method, as referenced on pages 38-39 of my direct testimony, is a
7 customer charge method approved by the Commission in a 2014 water base rate
8 case for Aqua Pennsylvania, Inc.³ This method calculated the basic customer cost
9 as the costs for meters and services, but also included other indirect costs such as
10 specific A&G costs, local taxes, and depreciation expense and return on general
11 and intangible plant (portions of buildings that are used for customer-related
12 activities, office equipment, and billing and meter data management systems).

13
14 **Q. WHAT IS THE REASON FOR THE DIFFERENCES BETWEEN YOUR**
15 **CUSTOMER CHARGE RECOMMENDATIONS AND MR. JOHNSON'S**
16 **PROPOSED CUSTOMER CHARGES?**

17 A. As supported by Mr. Siedt, Mr. Johnson's analysis relies entirely upon outdated
18 Commission guidance to determine the costs that are appropriately recovered
19 through a customer charge (Met-Ed/Penelec/Penn Power/West Penn St. No. 3-R).

³ *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Opinion and Order at Docket No. R-00038805 (Order entered August 5, 2004).

1 **Q. WHAT DID THE COMPANIES PROVIDE WITH RESPECT TO THEIR**
2 **CUSTOMER COST ANALYSES IN REBUTTAL TESTIMONY?**

3 A. Mr. Siedt states on pages 11 and 12 of his rebuttal testimony that he has provided
4 the components and amounts of each of the Companies' Exhibits KMS-3
5 ("Customer Charge Analysis") broken down by FERC account, which accompany
6 his rebuttal testimony as Exhibits KMS-9.

7
8 **Q. NOW THAT THE COMPANIES HAVE PROVIDED MORE DETAILED**
9 **INFORMATION CONCERNING THE DEVELOPMENT OF THEIR**
10 **CUSTOMER COST ANALYSES, DO YOU WISH TO REVISE YOUR**
11 **CUSTOMER COST ANALYSES?**

12 A. Yes. My revised customer cost analyses are presented in I&E Exhibit No. 3-SR,
13 Schedules 1 through 4. Utilizing the detailed information provided by the
14 Companies in their Exhibits KMS-9, my revised customer cost analyses is an
15 attempt to refine those which accompanied my direct testimony in two ways.
16 First, I recognized the Commission's long standing practice of limiting the
17 customer charge to costs which vary directly with changes in the number of
18 customers on the system. Additionally, I limited the costs included in the
19 calculation of the proposed customer charges to only the revenue requirement
20 associated with those directly assignable customer-related costs and their related
21 indirect costs, as was the approach taken by PPL in its previously mentioned 2012
22 base rate case.

1 **Q. DO YOUR REVISED CUSTOMER COST ANALYSES PRODUCE**
2 **DIFFERENT RESULTS THAN THOSE ACCOMPANYING YOUR**
3 **DIRECT TESTIMONY?**

4 A. Yes. My adjustments are shown on column D of I&E Exhibit No. 3-SR,
5 Schedules 1 through 4. My adjustments are a combination of limiting my
6 previously allowed indirect costs to only the customer-related portion of those
7 costs, provided by the Companies' Exhibits KMS-9, an allowance of the
8 depreciation expense and return on certain general and intangible plant (portions
9 of buildings that are used for customer-related activities, office equipment, and
10 billing and meter data management systems), and the inclusion of customer
11 assistance expense (Account 908), which consists of call center-related expenses.
12 Specifically, for residential customers, my revised customer cost analyses produce
13 the following results:

Cost Per Residential Customer Per Month

	I&E Direct Testimony <u>Ref. I&E Ex. No. 3 Schs. 6-9, p. 1, ln. 34</u>	I&E Revised Analyses <u>Ref. I&E Ex. No. 3-SR Schs. 1-4, p. 1, ln. 40</u>
Met-Ed	\$10.72	\$12.05
Penelec	\$11.25	\$11.86
Penn Power	\$9.75	\$9.90
West Penn	\$9.74	\$10.64

1 **Q. WHAT IS YOUR RATIONALE FOR EXCLUDING ALL CLAIMED**
2 **ADMINISTRATIVE AND GENERAL EXPENSES WITH THE**
3 **EXCEPTION OF EMPLOYEE PENSION AND BENEFITS?**

4 A. A large part of the costs included in Mr. Siedt's customer cost analyses are
5 indirect costs which do not vary with the number of customers. A substantial
6 portion of the costs are not allocable on any direct basis, such as administrative
7 and general expenses. In addition to a large share of general and advertising
8 expense, Mr. Siedt's customer cost analyses also include a portion of storm
9 damage costs. As explained above, the customer cost analysis adopted in the
10 Aqua case, upon which I have based my customer cost analyses and which the
11 Companies claim are the basis for their customer cost analyses, only includes
12 administrative and general expenses associated with Employee Health Plans.
13 Furthermore, although the Commission found that it was reasonable to include
14 general and administrative costs, such as Employee Health Plans in a customer
15 cost analysis, it also found that such claims are subject to scrutiny on a case-by-
16 case basis. Therefore, guided by the Commission's conclusion in that case, I have
17 determined that these are the only allowable administrative and general expenses.

18
19 **Q. EXPLAIN WHY YOU HAVE NOT ALLOCATED 100% OF THE**
20 **UNCOLLECTIBLE ACCOUNTS EXPENSE TO THE CUSTOMER COST**
21 **FUNCTION.**

1 A. I believe that the Companies should have allocated most of the uncollectible
2 accounts expense to the usage cost functions rather than the customer cost
3 function.

4
5 **Q. WHY DO YOU RECOMMEND THAT MOST OF THE UNCOLLECTIBLE**
6 **ACCOUNTS EXPENSE BE ALLOCATED TO THE USAGE FUNCTIONS?**

7 A. Collectively, the Companies receive approximately 18% to 28% of their revenues
8 from customer charges. Therefore, it is appropriate to allocate only approximately
9 18% to 28% of the uncollectible accounts expense to the customer function since
10 the customer costs are only responsible for a minority of the uncollectible accounts
11 expense.

12
13 **Q. WHAT IS MR. SIEDT'S POSITION CONCERNING YOUR EXCLUDED**
14 **PORTION OF UNCOLLECTIBLE ACCOUNTS EXPENSE?**

15 A. Mr. Siedt claims that my exclusion is not correct in concept and that by excluding
16 a portion of uncollectible accounts expense I have understated the customer costs
17 in my customer cost analyses (Met-Ed/Penelec/Penn Power/West Penn St. No. 3-
18 R, pp. 17-19).

19
20 **Q. WHAT IS THE BASIS OF MR. SIEDT'S CLAIM THAT THE CONCEPT**
21 **UNDERLYING YOUR EXCLUSION OF A PORTION OF**
22 **UNCOLLECTIBLE ACCOUNTS EXPENSE IS INCORRECT?**

1 A. Mr. Siedt believes that allocating cost in the system wide cost of service study
2 justifies inclusion of the same types of costs in the customer cost analysis.
3 Therefore, Mr. Siedt claims that since the total uncollectible accounts expense is
4 recognized to be customer-related for the determination of class revenue
5 responsibility, the total expense should also be included in determination of
6 customer charge recovery (Met-Ed/Penelec/Penn Power/West Penn St. No. 3-R,
7 p. 18).

8
9 **Q. IS IT CORRECT TO UTILIZE THE FUNCTIONALIZATION OF COST**
10 **IN A COST OF SERVICE STUDY TO JUSTIFY INCLUDING THOSE**
11 **COSTS IN THE CUSTOMER COT ANALYSIS?**

12 A. No. They are two separate analyses. While the customer cost analysis is generally
13 based on the cost of service study, a customer cost analysis is more focused and done
14 to determine the proper direct (and limited indirect) costs that should be recovered in
15 the customer charge within a specific customer class.

16 As shown by Mr. Siedt's customer cost analyses attached to his rebuttal
17 testimony as Exhibits KMS-9, Mr. Siedt has already excluded customer-related
18 minimum grid costs from his evaluation. Thus, he has already accepted the fact
19 that classification of a cost as customer-related in the cost of service study does
20 not deem the cost recoverable through the customer charge. The remaining
21 question is what portion, if any, of customer classified expenses which have a

1 weak or non-existent relationship to the number of customers should be recovered
2 through the customer charge.

3
4 **Q. HAVE YOU DETERMINED THE PORTIONS OF UNCOLLECTIBLE**
5 **ACCOUNTS EXPENSE THAT SHOULD BE ALLOCATED TO THE**
6 **CUSTOMER FUNCTION IN THE DETERMINATION OF THE**
7 **RESIDENTIAL CUSTOMER COSTS?**

8 A. Yes. I began by determining the percent of residential revenue received from the
9 customer charges for each Company. Then I multiplied the amount of residential
10 uncollectible accounts expense each Company claimed by these percentages to
11 determine the amounts that should be allocated to as a customer cost in the
12 residential customer charge analyses.

13
14 **Q. ARE THERE ANY OTHER WAYS IN WHICH MR. SIEDT CLAIMS YOU**
15 **HAVE UNDERSTATED THE PORTION OF UNCOLLECTIBLE**
16 **ACCOUNTS EXPENSE THAT SHOULD BE INCLUDED IN THE**
17 **CUSTOMER COST ANALYSES?**

18 A. Yes. Mr. Siedt states that I have calculated the customer-related portion of
19 residential uncollectible accounts expense based on the percentage of residential
20 customer charge revenue (numerator) to total residential revenue, including
21 revenue from transmission and generation-related charges (denominator). He
22 believes this is incorrect and that revenue from transmission and generation-

1 related charges should be unbundled and excluded from my calculations (Met-
2 Ed/Penelec/Penn Power/West Penn St. No. 3-R, pp. 18-19).

3
4 **Q. HAVE THE COMPANIES UNBUNDLED THE UNCOLLECTIBLE**
5 **ACCOUNTS EXPENSE ATTRIBUTABLE TO TRANSMISSION AND**
6 **GENERATION-RELATED CHARGES?**

7 A. No. They have not. The uncollectible accounts expense claim shown on the
8 Companies' Exhibit TJD-1 is not unbundled, nor are the total residential revenues
9 shown on Met-Ed Exhibit TJD-1, Section 1, page 14, Penelec Exhibit TJD-1,
10 Section 1, page 14, Penn Power Exhibit TJD-1, Section 1, page 15, and West Penn
11 Exhibit TJD-1, Section 1, page 14, which I have used in my calculations.

12
13 **Q. IF THE COMPANIES UNBUNDLE UNCOLLECTIBLE ACCOUNTS**
14 **EXPENSE IN THE FUTURE, WOULD THIS RESULT IN A LARGER**
15 **PERCENTAGE OF UNCOLLECTIBLE ACCOUNTS EXPENSE BEING**
16 **ALLOCATED TO THE CUSTOMER CHARGE?**

17 A. Yes, but then the total uncollectible accounts expense would be smaller since
18 some of the uncollectible accounts expense will be allocated and recovered
19 through energy charges, thus lowering the amount allocated to the distribution
20 revenue. And it is also likely to be done in a rate case.

1 **RESIDENTIAL CUSTOMER CHARGE RECOMMENDATION**

2 **Q. DID YOU RECOMMEND CHANGES TO THE COMPANIES' PROPOSED**
3 **RESIDENTIAL CUSTOMER CHARGES?**

4 A. Yes. I recommended that Met-Ed's present \$10.25 per month residential customer
5 charge be increased to \$10.72 per month, as opposed to Met-Ed's proposed
6 residential customer charge of \$17.42 per month, Penelec's present \$9.99 per
7 month residential customer charge be increased to \$11.25 per month, as opposed
8 to Penelec's proposed residential customer charge of \$17.10 per month, West
9 Penn's present \$5.81 per month residential customer charge be increased to \$9.74
10 per month, as opposed to West Penn's proposed residential customer charge of
11 \$13.98 per month, and Penn Power to maintain its current monthly residential
12 customer charge of \$10.85, as opposed to Penn Power's proposed residential
13 customer charge of \$13.41 per month (I&E St. No. 3, p. 44).

14
15 **Q. WHAT WAS THE BASIS FOR YOUR RECOMMENDATION**
16 **REGARDING THE APPROPRIATE LEVEL OF RESIDENTIAL**
17 **CUSTOMER CHARGES FOR EACH COMPANY?**

18 A. My customer charge recommendations were based on my customer cost analyses
19 which were provided as Schedules 6 through 9 of I&E Exhibit No. 3
20 accompanying my direct testimony.

1 **Q. BASED ON YOUR REVISED CUSTOMER COST ANALYSES, WHAT**
2 **RESIDENTIAL CUSTOMER CHARGES DO YOU RECOMMEND FOR**
3 **EACH COMPANY?**

4 A. Based on my revised customer cost analyses which I have identified as Schedules
5 1 through 4 of I&E Exhibit No. 3-SR, I recommend that Met-Ed's present \$10.25
6 per month residential customer charge be increased to \$12.05 per month,
7 Penelec's present \$9.99 per month residential customer charge be increased to
8 \$11.86 per month, West Penn's present \$5.81 per month residential customer
9 charge be increased to \$10.64 per month, and Penn Power to maintain its current
10 monthly residential customer charge of \$10.85, in recognition that Penn Power
11 only incurs approximately \$9.90 of customer costs per month for each residential
12 customer.

13
14 **REVENUE ALLOCATION**

15 **Q. DID YOU PROPOSE REVENUE ALLOCATIONS THAT WERE**
16 **DIFFERENT FROM THE COMPANIES IN YOUR DIRECT**
17 **TESTIMONY?**

18 A. Yes. In direct testimony I proposed that the revenue increase for each of the
19 Companies be reallocated to the various classes as presented in I&E Exhibit No. 3,
20 Schedules 2 through 5.

1 **Q. WHAT WAS THE BASIS FOR YOUR REALLOCATIONS OF THE**
2 **REVENUE INCREASES?**

3 A. The basis for developing my recommended revenue allocations were the same as
4 those used by the Companies, their prepared cost of service studies which they
5 state were prepared in the same manner consistent with principles and methods
6 that were approved in the 2012 PPL base rate case decision.

7
8 **Q. WHAT OBSERVATIONS DID YOU HAVE CONCERNING THE**
9 **COMPANIES' REVENUE ALLOCATIONS?**

10 A. I observed that the Companies' proposed revenue allocations move most but not
11 all classes closer to the system average rate of return. I indicated in my direct
12 testimony that the Companies' proposed revenue allocations to certain groups do
13 not move towards eliminating subsidies but instead exacerbate the existing degree
14 of cross-subsidization (I&E St. No. 3, pp. 32-33).

15
16 **Q. WHAT GENERAL APPROACH DID YOU TAKE IN ALLOCATING THE**
17 **COMPANIES' REQUESTED INCREASES AMONG THEIR RESPECTIVE**
18 **CLASSES?**

19 A. The concept of gradualism is integrated into my overall approach to revenue
20 allocation. I started with the Companies' proposed rate increases for each class. I
21 then identified the rate classes where the Companies' proposal results in revenues
22 in excess of the cost to serve those classes, and adjusted the Companies' proposal

1 downward accordingly. I then allocated the shortfall to the other rate classes,
2 which are being subsidized by the previously mentioned classes. I've done this
3 while imposing a constraint on my reallocation to not permit any class to which I
4 assigned the shortfall to incur an increase in excess of 1.5 times the system
5 average.

6
7 **Q. HAVE THE COMPANIES ADDRESSED YOUR RECOMMENDED**
8 **REVENUE ALLOCATIONS IN THEIR REBUTTAL TESTIMONIES?**

9 A. Yes. Mr. Siedt claims that while my recommended revenue allocations are not
10 outside the range of reasonableness, the Companies' method of tempering class
11 revenue increases is more "nuanced." Mr. Seidt believes that the Companies'
12 approach is preferable (Met-Ed/Penelec/Penn Power/West Penn St. No. 3-SR, pp.
13 25-26).

14
15 **Q. HAS MR. SIEDT PROVIDED ANY SUPPORT OR STATE WHY HE**
16 **BELIEVES YOUR RECOMMENDATION IS INCORRECT,**
17 **UNREASONABLE, OR UNNECESSARY?**

18 A. No. Therefore, I continue to support my method of allocating each of the
19 Companies' requested annual revenue increases among their respective classes.

20
21 **Q. DID THE OCA ADDRESS YOUR RECOMMENDED ALLOCATIONS OF**
22 **THE COMPANIES' REQUESTED ANNUAL REVENUE INCREASES?**

1 A. Yes. Mr. Johnson claims that my recommendations to exempt certain classes from
2 any revenue increase and increase the residential class revenues above the
3 Companies' proposals is unnecessarily rapid. Additionally, Mr. Johnson also
4 concluded that my recommendations were at odds with the results of his cost of
5 service study, shown on Schedule CJ-6 of OCA Statement No. 3, which produces
6 a lower increase for the residential classes than the Companies' proposals in each
7 case (OCA St. No. 3-R, pp. 13-14).

8
9 **Q. WHAT IS YOUR RESPONSE TO MR. JOHNSON'S CRITICISMS OF**
10 **YOUR REVENUE ALLOCATION PROPOSALS?**

11 A. Historically the Commission has recognized that a cost allocation study serves as a
12 guide, and is one of several important factors to be considered, when designing a
13 utility's rates. As indicated by James L. Crist on behalf of The Pennsylvania State
14 University (PSU St. No. 1-R, p. 9), the role of cost of service study has become
15 somewhat more important in light of the *Lloyd* decision, which held that cost
16 should be the "polestar" for revenue allocation and rate design.

17 Mr. Johnson provided extensive criticism of the Companies' cost of service
18 studies and his proposed changes, if adopted, would considerably reduce the level
19 of costs assigned to the residential classes. OSBA, which represents small and
20 large commercial and industrial customers, generally supports the Companies'
21 cost of service studies, listing a few minor concerns with Penn Power and West
22 Penn studies. As indicated by Mr. Siedt on page 8 of Met-Ed Statement No. 3,

1 one of the Companies' goals in the development of proposed rates has been to
2 achieve a unified distribution rate design for all four of the FirstEnergy companies.
3 This goal should be in addition to moving all rate classes towards each system's
4 average rate of return and ultimately cost-based rates. The movement toward both
5 of these goals should be measured on a generally consistent basis. Therefore, I do
6 not believe the methodology used by the Companies in these proceedings, and in
7 their previous proceedings, should be substantially altered, as proposed by Mr.
8 Johnson. For these reasons I maintain my reliance on the Companies' cost of
9 service studies in allocating each of the Companies' requested annual revenue
10 increases among their respective classes.

11
12 **Q. WHAT IS YOUR RESPONSE TO MR. JOHNSON'S ASSERTION THAT**
13 **YOUR PROPOSED REVENUE DISTRIBUTION FOR PENN POWER IS**
14 **UNREASONABLE?**

15 A. Mr. Johnson claims that in the case of Penn Power, in which the residential class is
16 above cost under current rates, I continue to propose an above system average
17 percent increase for the class, moving it farther from cost (OCA St. No. 3-R,
18 pp. 14-15). Under current rates, the relative rate of return is 1.06 for the
19 residential class, under Penn Power's proposed rates it is 0.99, and under my
20 recommended revenue allocation in my direct testimony it is 1.08. My
21 recommended allocation of Penn Power's requested increase to its residential class

1 results in a 44.3 % increase, which is 103.3% of Penn Power's requested system
2 average increase (well below my established limit of 150% of the system average).
3

4 **Q. HAVE YOU ADDRESSED MR. JOHNSON'S CONCERN THAT YOUR**
5 **RECOMMENDED REVENUE ALLOCATION FOR PENN POWER IS**
6 **UNFAIR TO THE RESIDENTIAL CLASS BY EXCLUDING OTHER**
7 **CLASSES FROM BEARING A LARGER PORTION OF THE**
8 **REQUESTED INCREASE?**

9 A. Yes. Mr. Johnson's concern is addressed later in my surrebuttal testimony and
10 considered in my revised revenue allocation recommendation for Penn Power.
11 The reasonableness of my revised revenue allocation recommendation for Penn
12 Power, put forth later in my surrebuttal testimony, is demonstrated by moving the
13 residential class's relative rate of return from 1.06 under current rates to 1.05
14 under my recommended allocation, thereby making progress toward cost-based
15 rates.
16

17 **Q. DID ANY OTHER PARTIES ADDRESS YOUR RECOMMENDED**
18 **ALLOCATIONS OF THE COMPANIES' REQUESTED ANNUAL**
19 **REVENUE INCREASES?**

20 A. Yes. OSBA witnesses Brian Kalcic and Robert D. Knecht, as well as Jeffry
21 Pollock on behalf of MEIUG, PICA, and WPPII, disagree with my approach
22 which imposes the 1.5 times system average limit on classes to which I allocate

1 additional revenues that are under their cost to serve, but not on the Companies'
2 proposal itself (OSBA St. No. 1-R, p. 5, OSBA St. No. 2-R, pp. 16-17, and
3 MEIUG, PICA, WPPII St. No. 1-R, pp. 11-12). AK Steel's witness, Richard A.
4 Baudino argues on page 7 of his rebuttal testimony that my recommendations are
5 based on West Penn's flawed cost of service study that overstates the cost
6 responsibility of primary service customers for substation costs.

7
8 **Q. HOW DO YOU RESPOND TO MR. KALCIC, MR. KNECHT, AND**
9 **MR. POLLOCK THAT CLASS INCREASES OF NO MORE THAN 150%**
10 **OF THE REQUESTED SYSTEM AVERAGE INCREASE SHOULD**
11 **APPLY TO ALL RATE CLASSES SERVED, REGARDLESS OF THEIR**
12 **RELATIVE RATE OF RETURN?**

13 A. When considering the appropriateness of a utility's revenue allocation and rate
14 design, it must be recognized for what it is; an art, not an exact science. Although,
15 there is no single correct method, there are certain fundamental principles, such as
16 cost causation, that should be followed. As stated in my direct testimony, my
17 primary objective is to bring the revenues received from each of the Companies'
18 classes as close to the cost of providing service as possible. The limitation I imposed
19 on realizing this objective is one based on the idea of gradualism, confining any
20 increase I allocate to a class generating revenues less than the corresponding cost of
21 providing service to no more than 1.5 times the system average increase. In light of
22 my primary objective, I did not recommend any reductions to the amount of revenue

1 increases allocated to classes whose relative rates of return at proposed rates are
2 below 1.0 and therefore generating revenues less than the corresponding cost of
3 providing service.
4

5 **Q. HAS THE COMPANIES' WITNESS MR. SIEDT MISINTERPRETED**
6 **YOUR SCALE BACK RECOMMENDATIONS STATED IN YOUR**
7 **DIRECT TESTIMONY?**

8 A. Yes.
9

10 **Q. HOW HAS MR. SIEDT MISINTERPRETED YOUR SCALE BACK**
11 **RECOMMENDATIONS?**

12 A. Mr. Siedt states on page 27 of his rebuttal testimony that I have proposed "first
13 dollar" reductions to specific classes before applying a proportional scale back
14 (Met-Ed/Penelec/Penn Power/West Penn St. No. 3-R). Nowhere in my direct
15 testimony do I suggest such a treatment should the Commission grant less than the
16 full increase requested by the Companies. The recommendation in my direct
17 testimony and as it continues to be, is a proportional scale back for each of the
18 Companies, with the exception of those classes not receiving an increase in base
19 rates under my recommended revenue allocations.

20 Therefore, based on my revised revenue allocations described later in my
21 surrebuttal testimony, should the Commission grant the Companies less than the
22 full increase they have requested, I recommend that each classes proposed rates be

1 reduced so that the increase for each class is proportional to the percentage
2 increase shown on I&E Exhibit 3-SR, Schedules 5 through 8, line 34, excluding
3 those classes not receiving an increase under my recommended revenue
4 allocations.

5
6 **Q. HAVE THE COMPANIES MADE ANY REVISIONS TO THEIR COST OF**
7 **SERVICE STUDIES IN REBUTTAL TESTIMONY?**

8 A. Yes. The cost of service studies, which originally accompanied the direct
9 testimony of Thomas J. Dolezal as Exhibits TJD-1 for each of the Companies,
10 have been revised with the following corrections and revisions and are provided as
11 Exhibits TJD-1-R:

- 12 • For Met-Ed, the tax deduction related to the amortization of legacy meters
13 was inadvertently omitted from the calculation of income subject to state
14 and federal taxes;
- 15 • Met-Ed's meter allocator inadvertently excluded certain meter costs for
16 Met-Ed rate schedule TP;
- 17 • West Penn's study inadvertently used write-off's to allocate forfeited
18 discount revenues;
- 19 • The value for West Penn CLS_367_P&S was corrected;
- 20 • The West Penn CLS_364, CLS_365, and CLS_367 classifiers inadvertently
21 excluded subtransmission plant costs;

- 1 • The non-coincident peak (“NCP”) for all Penn Power rate classes was
2 updated to include recently available settlement data for November 2015
3 and December 2015;
- 4 • For all Companies, the allocation factor for overhead conductor O&M costs
5 (Accounts 583 and 593) was modified to include plant related to poles,
6 overhead conductors, and services, and to include subtransmission plant for
7 West Penn;
- 8 • For all Companies, the allocation factor for underground conductor O&M
9 Costs (Accounts 584 and 594) was modified to include plant related to
10 conduit and underground conductors, and to include subtransmission plant
11 for West Penn.

12
13 **Q. GIVEN THE COMPANIES’ REVISED COST OF SERVICE STUDIES, DID**
14 **THEY REVISE THE ALLOCATIONS OF THEIR REQUESTED**
15 **REVENUE INCREASES AMONG THEIR CUSTOMER CLASSES?**

16 A. No, they did not. The proposals the Companies have made in their initial filings,
17 which are reflected on pages 4, 13, 20, and 29 of my direct testimony, concerning
18 the distribution of their requested revenue increases among their respective
19 customer classes, have not been changed or updated in their rebuttal testimonies.

REVENUE ALLOCATION – MET-ED

Q. NOW THAT MET-ED HAS REVISED ITS COST OF SERVICE STUDY UPON WHICH ITS PROPOSED CLASS REVENUE INCREASE ALLOCATION IS BASED, DID YOU FIND IT NECESSARY TO REEVALUATE THE REASONABLENESS OF MET-ED’S PROPOSED CLASS INCREASES?

A. Yes. The following table is an update from the one shown on page 8 of my direct testimony, which compares Met-Ed’s cost of service and its revenues under proposed rates.

Met-Ed COS and Revenues Under Proposed Rates (\$1,000)			
Customer Class	Cost of Service	Proposed Revenues	Difference
RS	\$356,759	\$340,942	(\$15,817)
GSV	\$371	\$621	\$250
GSS	\$23,498	\$19,477	(\$4,021)
GSM	\$48,398	\$61,876	\$13,478
GSL	\$14,600	\$15,117	\$517
GP	\$32,172	\$36,541	\$4,369
TP	\$5,534	\$4,931	(\$603)
BRD	\$104	\$51	(\$53)
MS	\$118	\$138	\$20
POL	\$1,072	\$1,073	\$1
STLT	\$5,703	\$7,563	\$1,860
Total	\$488,330	\$488,330	\$0

1 It appears that the GSL and GP classes received an increase in proportion to their
2 cost-based revenue requirement at proposed revenue levels, but were also
3 allocated additional increases of \$517,000 and \$4,369,000 respectively as a result
4 of the limited increases proposed for the GSM, MS, POL, and STLT classes.
5 However, the GSM class is still recovering over 65% of the RS, GSS, TP, and
6 BRD revenue shortfall.

7
8 **Q. DO YOU WISH TO REVISE YOUR REVENUE ALLOCATION**
9 **RECOMMENDATION FOR MET-ED AS A RESULT OF ITS REVISED**
10 **COST OF SERVICE STUDY?**

11 A. Yes. Using the same methodology and guidelines as described in my direct
12 testimony, I have revised my revenue allocation recommendation for Met-Ed as
13 shown on I&E Exhibit No. 3-SR, Schedule 5. My revised recommended revenue
14 allocation adjusts Met-Ed's proposed revenue allocation by re-allocating
15 approximately \$17,694,000 from the GSM, GSL, GP, MS, and STLT classes to
16 the RS, GSV, GSS, and TP classes (I&E Ex. No. 3-SR, Sch. 5, Ins. 9 and 30). The
17 result, as shown on line 28 of I&E Exhibit No. 3-SR, Schedule 5, is that the rates
18 of return of the various customer classes move closer to the system average, with
19 the exception of the GSV class due to shared rates with the RS class.

REVENUE ALLOCATION - PENELEC

Q. NOW THAT PENELEC HAS REVISED ITS COST OF SERVICE STUDY UPON WHICH ITS PROPOSED CLASS REVENUE INCREASE ALLOCATION IS BASED, DID YOU FIND IT NECESSARY TO REEVALUATE THE REASONABLENESS OF PENELEC'S PROPOSED CLASS INCREASES?

A. Yes. The following table is an update from the one shown on page 16 of my direct testimony, which compares Penelec's cost of service and its revenues under proposed rates.

Penelec COS and Revenues Under Proposed Rates (\$1,000)			
Customer Class	Cost of Service	Proposed Revenues	Difference
RS	\$368,101	\$343,586	(\$24,515)
GSV	\$670	\$1,093	\$423
GSS	\$32,729	\$21,263	(\$11,466)
GSM	\$57,161	\$93,989	\$36,828
GSL	\$15,147	\$20,900	\$5,753
GP	\$27,375	\$25,465	(\$1,910)
LP	\$10,070	\$13,200	\$3,130
BRD	\$15	\$26	\$11
H	\$748	\$965	\$217
POL	\$3,420	\$4,955	\$1,535
STLT	\$18,450	\$8,455	(\$9,995)
Total	\$533,899	\$533,899	\$0

1 It appears that all rate classes are moving closer to the system average rate of
2 return; however, the GSM class is still recovering over 76% of the revenue
3 shortfall from the RS, GSS, GP, and STLT classes.
4

5 **Q. DO YOU WISH TO REVISE YOUR REVENUE ALLOCATION**
6 **RECOMMENDATION FOR PENELEC AS A RESULT OF ITS REVISED**
7 **COST OF SERVICE STUDY?**

8 A. Yes. Using the same methodology and guidelines as described in my direct
9 testimony, I have revised my revenue allocation recommendation for Penelec as
10 shown on I&E Exhibit No. 3-SR, Schedule 6. My revised recommended revenue
11 allocation adjusts Penelec's proposed revenue allocation by re-allocating
12 approximately \$28,633,000 from the GSM, GSL, LP, H, and POL classes to the
13 RS, GSV, GSS, GP, and STLT classes (I&E Ex. No. 3-SR, Sch. 6, lns. 9 and 30).
14 The result, as shown on line 28 of I&E Exhibit No. 3-SR, Schedule 6, is that the
15 rates of return of the various customer classes move closer to the system average,
16 with the exception of the GSV class due to shared rates with the RS class.
17

18 **REVENUE ALLOCATION – PENN POWER**

19 **Q. NOW THAT PENN POWER HAS REVISED ITS COST OF SERVICE**
20 **STUDY UPON WHICH ITS PROPOSED CLASS REVENUE INCREASE**
21 **ALLOCATION IS BASED, DID YOU FIND IT NECESSARY TO**

**REEVALUATE THE REASONABLENESS OF PENN POWER'S
PROPOSED CLASS INCREASES?**

A. Yes. The following table is an update from the one shown on page 24 of my direct testimony, which compares Penn Power's cost of service and its revenues under proposed rates.

Penn Power COS and Revenues Under Proposed Rates (\$1,000)			
Customer Class	Cost of Service	Proposed Revenues	Difference
RS	\$98,713	\$97,646	(\$1,067)
GSR	\$56	\$87	\$31
GSS	\$6,763	\$6,325	(\$438)
GSM	\$13,607	\$15,646	\$2,039
GSL	\$3,280	\$5,129	\$1,849
GP	\$8,326	\$5,980	(\$2,346)
OH	-	-	-
PNP	\$82	\$96	\$14
POL	\$676	\$565	(\$111)
STLT	\$2,735	\$1,105	(\$1,630)
GT	\$308	\$1,966	\$1,658
Total	\$134,544	\$134,544	\$0

It appears that all rate classes are moving closer to the system average rate of return. However, in its attempt at lowering the relative rate of return for the RS class, the Company limited the allocation of its requested annual revenue increase in such a strict manner that the cost of providing service is now more than the revenue received from the RS class. Additionally, the GSM, GSL, and GT classes

1 are still recovering the majority of revenue shortfall from the RS, GSS, GP, POL,
2 and STLT classes.

3
4 **Q. DO YOU WISH TO REVISE YOUR REVENUE ALLOCATION**
5 **RECOMMENDATION FOR PENN POWER AS A RESULT OF ITS**
6 **REVISED COST OF SERVICE STUDY?**

7 A. Yes. Using the same methodology and guidelines as described in my direct
8 testimony, I have revised my revenue allocation recommendation for Penn Power
9 as shown on I&E Exhibit No. 3-SR, Schedule 7. My revised recommended
10 revenue allocation adjusts Penn Power's proposed revenue allocation by re-
11 allocating approximately \$4,149,000 from the GSM, GSL, PNP, and GT classes to
12 the RS, GSR, GSS, POL, and STLT classes (I&E Ex. No. 3-SR, Sch. 7, Ins. 9
13 and 30). The result, as shown on line 28 of I&E Exhibit No. 3-SR, Schedule 7, is
14 that the rates of return of the various customer classes move closer to the system
15 average, with the exception of the GSR class due to shared rates with the RS class.

16
17 **Q. WHAT HAVE YOU DONE TO ADDRESS OCA WITNESS JOHNSON'S**
18 **CONCERN DESCRIBED ABOVE THAT YOUR RECOMMENDED**
19 **REVENUE ALLOCATION FOR PENN POWER IS UNFAIR TO THE**
20 **RESIDENTIAL CLASS?**

21 A. Due to the limited increases for the GSS, POL, and STLT classes, my
22 recommended revenue allocation makes the relative rates of return for the RS and

1 GSM classes the same. With both groups producing approximately the same
2 relative rate of return, they are contributing the same proportion of revenue
3 shortfall (I&E Ex. No. 3-SR, Sch. 7, cols. C and F, ln. 28).
4

5 **REVENUE ALLOCATION – WEST PENN**

6 **Q. NOW THAT WEST PENN HAS REVISED ITS COST OF SERVICE**
7 **STUDY UPON WHICH ITS PROPOSED CLASS REVENUE INCREASE**
8 **ALLOCATION IS BASED, DID YOU FIND IT NECESSARY TO**
9 **REEVALUATE THE REASONABLENESS OF WEST PENN’S**
10 **PROPOSED CLASS INCREASES?**

11 A. Yes. The following table is an update from the one shown on page 32 of my direct
12 testimony, which compares West Penn’s cost of service and its revenues under
13 proposed rates.

West Penn COS and Revenues Under Proposed Rates (\$1,000)			
Customer Class	Cost of Service	Proposed Revenues	Difference
RS	\$330,873	\$319,550	(\$11,323)
GS10	\$430	\$809	\$379
GSS	\$28,663	\$18,537	(\$10,126)
GSM	\$50,033	\$68,641	\$18,608
PP40	\$13,891	\$12,474	(\$1,417)
GSL	\$20,964	\$24,789	\$3,825
POL	\$3,030	\$7,959	\$4,929
PSU	\$1,097	\$1,168	\$71
PP44	\$3	\$65	\$62
PP46	\$4,582	\$4,051	(\$531)
STLT	\$10,013	\$5,535	(\$4,478)
Total	\$463,579	\$463,579	\$0

It appears that all rate classes are moving closer to the system average rate of return except for rate groups POL, PP44, and STLT. Under current rates, the revenue received from rate groups POL and PP44 exceed the cost of providing service to those groups. West Penn proposes to allocate a portion of its requested annual revenue increase to these two rate groups, resulting in a 74.9% increase in annual revenues from the POL rate group and a 107.5% increase in annual revenues from the PP44 rate group. These increases in annual revenue proposed for the POL and PP44 rate groups do not move towards eliminating subsidies that these rate groups are currently providing and only exacerbate the existing degree of cross-subsidization. The same effect is produced by West Penn's proposed

1 decrease in annual revenues for the STLT rate group. Under current rates, the cost
2 of providing service to this group exceeds the revenue received. Therefore, by
3 reducing the annual revenue received from this rate group the existing degree of
4 subsidization is enhanced. Additionally, the GSM, GSL, and POL classes are still
5 recovering the majority of revenue shortfall from the RS, GSS PP40, PP46, and
6 STLT rate groups.

7
8 **Q. DO YOU WISH TO REVISE YOUR REVENUE ALLOCATION**
9 **RECOMMENDATION FOR WEST PENN AS A RESULT OF ITS**
10 **REVISED COST OF SERVICE STUDY?**

11 A. Yes. Using the same methodology and guidelines as described in my direct
12 testimony, I have revised my revenue allocation recommendation for West Penn as
13 shown on I&E Exhibit No. 3-SR, Schedule 7. My revised recommended revenue
14 allocation adjusts West Penn's proposed revenue allocation by re-allocating
15 approximately \$10,812,000 from the GSM, GSL, POL, PSU, and PP44 classes to
16 the RS, GS10, PP40, PP46, and STLT classes (I&E Ex. No. 3-SR, Sch. 8, lns. 9
17 and 30). The result, as shown on line 28 of I&E Exhibit No. 3-SR, Schedule 8, is
18 that the rates of return of the various customer classes move closer to the system
19 average, with the exception of the GS10 class due to shared rates with the RS
20 class.

1 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

2 **A. Yes.**