



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

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February 17, 2010

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Petition of PPL Electric Utilities Corporation for Approval of a Smart
Meter Technology Procurement and Installation Plan

Docket No. M-2009-2123945

Dear Secretary McNulty:

Enclosed please find an original and nine (9) copies of the Office of Trial Staff's
(OTS) **Exceptions** in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

Allison C. Kaster
Prosecutor
Office of Trial Staff
PA Attorney I.D. #93176

Enclosure
ACK/edc

cc: Parties of record
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Vice Chairman Christy
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Director Davis

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of PPL Electric Utilities :
Corporation for Approval of its Smart : **Docket No. M-2009-2123945**
Meter Technology Procurement and :
Installation Plan :

**EXCEPTIONS
OF THE
OFFICE OF TRIAL STAFF**

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Allison C. Kaster
Prosecutor
PA Attorney I.D. #93176

Office of Trial Staff
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-1976

Dated: February 17, 2010

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I. INTRODUCTION

PPL Electric Utilities Corporation (PPL or Company) filed its Smart Meter Technology Procurement and Installation Plan (Smart Meter Plan or Plan) in accordance with Act 129¹ and the Commission's Smart Meter Procurement and Installation Implementation Order (Implementation Order)². This proceeding was assigned to Administrative Law Judge Wayne L. Weismandel (ALJ) who issued an Initial Decision (I.D.) on January 28, 2010.

The Office of Trial Staff (OTS) is charged with representing the public interest in Pennsylvania Public Utility Commission (Commission) proceedings having an impact on customer rates. The OTS representation of the public interest includes balancing the interests of ratepayers, utilities and the welfare of the Commonwealth. Throughout this proceeding, OTS has maintained that PPL's Plan should be approved as it appears to satisfy the minimum capabilities detailed in the Commission's Implementation Order. However, OTS made recommendations with regard to a Plan implementation schedule, cost recovery and the application of interest.

Pursuant to Section 5.533 of Commission Regulations³, OTS files the instant Exceptions to the I.D. The ALJ's rejection of the OTS recommendations were contrary to the public interest and OTS respectfully requests that the following exceptions be granted by the Commission.

¹ Act 129 of 2008, 66 Pa.C.S. §§ 2806.1, 2806.2.

² Smart Meter Procurement and Installation Implementation Order, Docket M-2008-2069887.

³ 52 Pa. Code § 5.533.

II. EXCEPTIONS

As will be discussed in greater detail below, the ALJ's rejection of the OTS recommendations with respect to capital structure, cost of equity, cost of debt, application of interest, procedural schedule and quarterly review is in error as the OTS recommendations were based on sound ratemaking principles and, importantly, were designed to streamline smart meter filings for all jurisdictional electric distribution companies (EDC). OTS made identical recommendations in all EDC smart meter filings to ensure that no utility or its ratepayers were improperly advantaged or disadvantaged through the implementation of Act 129's smart meter requirements.

Such streamlining has not occurred given that on the same date that the PPL I.D. was issued, decisions were also issued for Duquesne Light Company⁴ (Duquesne), FirstEnergy⁵ and PECO,⁶ which widely differed in the treatment of cost of capital, interest and the procedural schedule. For example, unlike the instant I.D. where the ALJ approved the application of interest based on Section 1307(f)(5),⁷ the FirstEnergy I.D. expressly denied the collection of interest on over

⁴ Duquesne Light Company's Petition for Approval of Smart Meter Procurement and Installation Plan, Docket M-2009-2123948.

⁵ Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan, Docket No. M-2009-2123950.

⁶ Petition of PECO Energy Company for Approval of its Smart Meter Technology Procurement and Installation Plan, Docket No. M-2009-2123944.

⁷ 66 Pa.C.S. § 1307(f)(5) (Provides for recovery from customers at the legal rate of interest and refunds to customers at the legal rate of interest plus 2%).

and under-collections and the Duquesne decision is largely silent on the interest issue.

The incongruent treatment of issues common to each EDC's Smart Meter Plan is inappropriate. As such, OTS urges the Commission to adopt the OTS recommendations discussed below, which are consistent with sound ratemaking principles and promote uniformity among EDC recovery of smart meter costs.

1. Exception No. 1: The Initial Decision Erred by Failing to Adopt the Proposed Procedural Schedule and Quarterly Filing Recommendation.

Initial Decision, p. 26.
OTS Main Brief, pp. 7-10.
OTS Reply Brief, pp. 1-4.

PPL proposed to recover its smart meter and EE&C costs through its Act 129 Compliance Rider ("ACR").⁸ OTS argued against this combined cost recovery approach and recommended that a separate tariff mechanism be created for smart meter cost recovery. PPL agreed to this proposal.⁹

OTS advocated for separate cost recovery in order to implement a uniform procedural schedule for all EDC smart meter filings. This proposed schedule had a twelve month reconciliation period ending June 30 of each Smart Meter Plan year. Based on this reconciliation period, the annual smart meter filing would occur no later than August 1, evidentiary hearings would be held by October 1,

⁸ Smart Meter Plan, Attachment 4.

⁹ PPL Main Brief, p. 11.

the Commission Order be issued on or before December 1 and a tariff effective date of January 1. Additionally, the proposed schedule was designed to incorporate quarterly filings so that revenues and costs could be reviewed in a timely manner and rates could be adjusted to reduce the likelihood of dramatic fluctuations.

While PPL did not oppose the creation of a separate tariff mechanism, the Company disagreed with the proposed schedule and quarterly rate adjustments asserting that both the ACR and the smart meter surcharge should be adjusted on the same date to minimize customer confusion arising from frequent rate changes.¹⁰ The ALJ erroneously agreed with PPL.¹¹ Such confusion is unlikely given that both EE&C and smart meter costs are applied to distribution base rates, rather than as a separate line item on customer bills. As such, it is unlikely that a separate smart meter adjustment will cause widespread confusion for PPL ratepayers.

The OTS proposed schedule was designed to promote administrative and judicial efficiency. OTS advocated for the identical procedural schedule in all smart meter proceedings to institute a uniform filing period for the EDCs. Such uniformity will not occur given that the schedule will be followed by Duquesne¹² and PECO¹³; however, the schedule was not adopted in the PPL¹⁴ and

¹⁰ PPL Main Brief, p. 17.

¹¹ PPL I.D., p. 26

¹² Duquesne I.D., pp. 21-23.

¹³ PECO I.D., p. 22.

FirstEnergy¹⁵ proceedings. Requiring all smart meter filings to follow the same procedural track was designed to avoid conflict with various other annual filings in order to provide the parties, Administrative Law Judges and the Commission sufficient time to analyze the programs and costs incurred to provide such technology to ratepayers. Because the I.D. ignores the benefit of allowing EDCs to recover smart meter costs in a procedurally efficient manner, the recommendation should not be accepted by the Commission.

Additionally, the proposed quarterly filings and adjustments will more accurately match revenues and costs as PPL will be reviewing such components on a more frequent basis. The timely review and ability to adjust rates will reduce the impact of any projection errors and should avoid dramatic fluctuations that could occur if such review occurs annually. As such, OTS recommends that the Commission require quarterly rate updates showing the projected revenues and recoverable costs. The reasonableness of the OTS recommendation is illustrated by the fact that it is currently used in the Distribution System Improvement Charge (“DSIC”) mechanism.¹⁶ The DSIC rate is recalculated quarterly and, pursuant to Section §1307(e) of the Public Utility Code, the utility is required to file an annual statement with the Commission showing the amount of DSIC revenues billed customers and the associated DSIC eligible costs.¹⁷ Accordingly, under the OTS proposal, rates will be reconciled annually in accordance with the Act and the

¹⁴ PPL I.D., p. 26.

¹⁵ FirstEnergy I.D., pp. 38-41.

¹⁶ OTS St. No. 1, p. 9.

¹⁷ 66 Pa. C.S. § 1307(e).

Implementation Order but those rates will be subject to quarterly review and adjustment.

2. Exception No. 2: The Initial Decision's Interest Recommendations are in Error.

Initial Decision, pp. 24-26.
OTS Main Brief, pp. 15-17.
OTS Reply Brief, pp. 8-9.

The I.D. ignored the recommendations made by PPL, OTS and OCA regarding the application of interest. Those parties agreed that it was proper to calculate interest charges as provided in Section 1308(d) of the Public Utility Code, which specifies that interest should be computed at the residential mortgage rate.¹⁸ However, OTS recommended that interest be one directional so that ratepayers are not liable for the payment of a net interest component due to the Company. The ALJ ignored these recommendations and found that interest should be bidirectional and computed as prescribed by Section 1307(f)(5).¹⁹ This provision mandates that recovery from customers for under-collections should be made at the legal rate of interest and refunds to customers of over-collections be made at the legal rate of interest plus two percent.

The ALJ's reliance on the interest provision contained in Section 1307(f) is in error. The residential mortgage lending rate contained in Section 1308(d) is the appropriate interest rate to apply in this proceeding because it represents the

¹⁸ PPL I.D., p. 24.

¹⁹ PPL I.D., pp. 25-26.

current cost of borrowed funds. While the ALJ cautions against use of the residential mortgage rate due to the potential fluctuations, those fluctuations are appropriate as it mirrors borrowing costs and current economic conditions.²⁰ The Commission has already recognized the appropriateness of applying the residential mortgage rate in surcharge mechanisms as it is currently used in DSIC proceedings. Like DSIC projects, smart meter technology will involve capital intensive investment by the Company; therefore, applying the residential mortgage rate is appropriate. Accordingly, the ALJ's reliance on § 1307(f)(5) must be rejected in favor of the residential mortgage rate contained in § 1308(d) as advanced by PPL, OCA and OTS.

The ALJ also rejected the OTS recommendation of one directional recovery of interest.²¹ Under this proposal, interest would be computed on over/under-collection activity for each month in the reconciliation period and, once calculated, only the net interest amount due to ratepayers would be incorporated into the smart meter cost recovery mechanism. As such, interest due to ratepayers as a result of an over-collection would be returned to ratepayers at the residential mortgage rate while interest due to the Company as a result of an under-collection would not be recovered from ratepayers. In denying OTS' one directional interest proposal, the I.D. maintains that PPL currently has multiple two directional cost recovery mechanisms.²² However, this argument overlooks the fact that the

²⁰ PPL I.D., p. 26.

²¹ PPL I.D., pp. 24-26.

²² PPL I.D., p. 24.

Commission has already recognized the applicability of applying one directional interest to capital intensive recovery in DSIC proceedings. Additionally, the I.D. erroneously rejected the OTS proposal because Act 129 permits the Company to recover costs on a “full and current basis.”²³ OTS does not dispute this requirement of the Act, but maintains that the Company’s smart meter cost recovery already allows for the recovery of carrying costs from ratepayers through a return component, which includes the cost rates of debt, preferred stock and common equity.²⁴ The ability to recover Plan costs through an annually reconciled and quarterly updated automatic adjustment clause satisfies the requirement for “full and current” recovery of smart meter technology costs regardless of the treatment of interest. As such, PPL is compensated for its investment through the application of the rate of return. The Company should not be permitted to collect interest on its rate of return; therefore, it is inappropriate to collect additional carrying cost on any under-collections.²⁵

It is important to note that the application of interest is an area that is widely divergent in the recently issued smart meter decisions. As discussed, the PPL I.D. mandates interest on over/under-recoveries under Section 1307(f)(5) of the Public Utility Code. In contrast, the FirstEnergy I.D. expressly denied the application of interest and the Duquesne I.D. failed to address this issue. As such, there is no consensus among the various ALJ decisions, despite the fact that the

²³ 66 Pa.C.S.A. § 2807(f)(7). PPL I.D., p. 25.

²⁴ OTS St. No. 1, p. 20.

²⁵ OTS St. No. 1-SR, p. 8.

interest should be uniformly applied to all EDC smart meter cost recovery. For the reasons stated herein, OTS continues to assert that its one directional application of the residential mortgage lending rate is appropriate.

3. Exception No. 3: The Initial Decision's Recommended Capital Structure is in Error.

Initial Decision, pp. 21-22.
OTS Main Brief, pp. 12-13.
OTS Reply Brief, p. 5.

The I.D.'s capital structure recommendation is inappropriately shortsighted as it relies on stale information from PPL's most recently litigated rate proceeding that was filed nearly six years ago.²⁶ OTS recommended that the Commission use a representative capital structure for all EDC smart meter cost recovery based upon the barometer group in the Quarterly Earnings Report.

The representative capital structure is important for two reasons. First, as will be discussed in greater detail below, the representative capital structure is based on the same barometer group that will be used to determine the appropriate cost rate of common equity. Therefore, under the OTS recommendation, the representative capital structure will properly match the financial risk associated with the corresponding cost rate of common equity.²⁷ Second, OTS is recommending a representative capital structure for all EDCs, which is important because some electric companies have capital structures that are not representative

²⁶ PPL I.D., p 23. *Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255.

²⁷ OTS St. No. 1, p. 15. OTS St. No. 1-R, p. 4. OTS St. No. 1-SR, p. 5.

of the industry norm.²⁸ As such, using a uniform representative capital structure will not advantage or disadvantage any EDC or its ratepayers.

While the PPL and FirstEnergy decisions contend that the capital structure must be EDC specific, the Duquesne proceeding demonstrates what happens when a capital structure is out of line with the industry norm. Duquesne reported that its actual equity is 67%, but proposed an equity capitalization “zone of reasonableness” of 45%-59%.²⁹ As long as Duquesne’s actual equity is above this range, the ALJ approved using the 59% equity ratio to determine its capital structure.³⁰ As such, based on these recent decisions, PPL and FirstEnergy will use the capital structures contained in their prior rate cases, while Duquesne will implement its zone of reasonableness approach. Approval of the OTS recommendation would avoid these deviations because all EDCs would use a capital structure that is updated regularly and is representative of the electric industry.

4. Exception No. 4: The Initial Decision Erred in Accepting PPL’s Cost Rate of Debt and Preferred Stock from its Base Rate Case Filed in 2004.

Initial Decision, pp. 21-22, 24.

OTS Main Brief, pp. 13-14.

OTS Reply Brief, p. 6.

²⁸ OTS St. No. 1, p. 15. OTS St. No. 1-R, pp. 4-5.

²⁹ Duquesne I.D., p. 29.

³⁰ Duquesne I.D., pp. 29-31.

The I.D. found that it was proper to use the cost rate of debt and preferred stock from PPL's fully litigated base rate proceeding filed on March 29, 2004.³¹ Doing so is in error as that data is nearly six years old. The OTS recommendation to use information contained in the Quarterly Financial Reports is preferable as it reflects the Company's current cost rate and will best reflect the cost of capital used to finance the smart meter technology.³² The ALJ criticizes the OTS recommendation as being inconsistent because it chooses different data points, some that reflect the Company's actual costs and others that do not.³³ As explained in OTS reply brief, this argument is true only on a superficial level because the reason for using actual or representative data is consistently applied in the OTS recommendations.³⁴ Specifically, when costs are fixed and do not fluctuate, such as debt and preferred stock, it is appropriate to utilize the utility's actual costs. The OTS debt cost recommendation uses PPL's actual and current costs as found in the quarterly reports rather than relying on stale data as recommended in the I.D. In contrast, the cost of equity and capital structure are not fixed and do fluctuate within the industry; therefore, the representative capital structure and equity cost is appropriate to ensure that no EDC or its customers are improperly harmed or advantaged through the smart meter cost recovery.

³¹ PPL I.D., p. 24. *Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255.

³² OTS St. No. 1, pp. 13-14.

³³ PPL I.D., p. 24.

³⁴ OTS R.B., p. 6.

Additionally, this is another area where the I.D.'s in the various smart meter proceedings diverge. In sharp contrast to the instant proceeding, the ALJs in FirstEnergy and Duquesne approved the request to utilize the Companies' Quarterly Financial Report to derive the cost rate of long term debt.³⁵ However, in this proceeding ALJ Weisman del contends that reliance on these reports is inferior to "[u]se of Company-specific data, from a single adjudicated proceeding, that has been reviewed and approved by the Commission will produce a more accurate reflection of PPL's capital costs."³⁶ This position is incorrect because use of the Quarterly Financial Report reflects the utility's actual and current costs. The fact that FirstEnergy is utilizing its quarterly reports to determine the cost rate of debt is significant because its most recent base rate proceeding was filed in 2006, nearly two years after PPL's most recent litigated proceeding. ALJ Weisman del's reliance on PPL's stale data is in error given that FirstEnergy's rate case is more recent, yet it is using the Quarterly Financial Report. Accordingly, OTS maintains that PPL, like FirstEnergy and Duquesne, should utilize the Quarterly Financial Report to determine its cost rate of debt.

5. Exception No. 5: The Initial Decision Erred in Accepting PPL's Cost Rate of Equity from its Base Rate Case Filed in 2004.

Initial Decision, pp. 22-23
OTS Main Brief, pp. 14-15.
OTS Reply Brief, pp. 6-8.

³⁵ FirstEnergy I.D., pp. 36-37 (It should be noted that the ALJ disapproved the blending of long-term debt and preferred stock.). Duquesne I.D., pp. 23-24 (The ALJ approved the blending of long-term debt and preferred stock.).

³⁶ PPL I.D., p. 24.

The I.D. inappropriately relies on the Company's most recently litigated rate case to determine the cost rate of common equity.³⁷ That rate case was filed on March 29, 2004, nearly six years ago.³⁸ These inputs may no longer be representative of the Company's current financial condition or the current economic conditions in the capital markets.³⁹ In his decision, ALJ Weismandel rejected the OTS recommendation that the cost rate of common equity for the electric industry be calculated by Commission staff and presented in the Quarterly Earnings Report to be used by all EDCs when calculating smart meter cost recovery.⁴⁰

The ALJ was erroneously guided by relying on PPL's *actual* equity return as determined in its 2004 rate proceeding; however, the implication that this return is solely PPL specific is misplaced. The 10.7% equity return determined in PPL's 2004 rate case was calculated by using various cost of common equity methodologies, which were applied to an industry barometer group.⁴¹ While some components to determine equity are specific to PPL, a barometer group is used to determine an appropriate equity range. In this proceeding, the OTS recommendation that the Commission calculate the cost rate of common equity and capital structure based on its barometer group is similar. The ALJ improperly takes the OTS witness to task as not being qualified to testify as to cost of

³⁷ PPL I.D., pp. 22-23.

³⁸ PPL I.D., p. 24. *Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255.

³⁹ OTS St. No. 1-SR, p. 4.

⁴⁰ OTS St. No. 1, p. 14. OTS St. No. 1-R, p. 7. OTS St. No. 1-SR, p. 3.

⁴¹ *Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255, pp. 60-72.

capital.⁴² It is evident that OTS did not make specific recommendations regarding how the cost rate of common equity should be calculated. Instead, as discussed above, the OTS recommended that FUS make those determinations as it currently does in DSIC proceedings. In those proceedings, the individual equity returns for the water utilities are not used. Rather, the Commission calculates a cost rate of common equity that is applied to all companies using a DSIC mechanism. Therefore, the OTS recommendation was simply to apply the methodology that is currently accepted Commission procedure to PPL's smart meter cost recovery.

The fact that the Quarterly Earnings Reports provide current information is important because reliance on PPL's 2004 base rate proceeding uses inputs that may no longer be representative of the Company's current financial condition or the current economic conditions in the capital markets.⁴³ The I.D. in the Duquesne proceeding recognized the importance of timely information. In consideration of OCA's recommendation to rely on the rate case equity return if the proceeding concluded within three years, the ALJ noted that the recommended three year period was appropriate as a starting point but commented that given the recent volatility in the financial markets, "[i]t is far from certain that an equity return found reasonable in the Spring of 2008 at the conclusion of a fully-litigated base rate case would be reasonable for an SMC charge as of April 1, 2010."⁴⁴ In doing so, the ALJ in the Duquesne proceeding recognized that much can change over a

⁴² PPL I.D., p. 23. *Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255.

⁴³ OTS St. No. 1-SR, p. 4.

⁴⁴ Duquesne I.D., p. 28.

three year period given the current turbulent financial climate. This further highlights that reliance on information used to determine a cost of common equity for PPL's base rate case filed nearly six years ago is in error.

The equity calculation is another important area where the ALJ's in the various smart meter proceedings have made inconsistent recommendations. Both PPL and FirstEnergy's I.D.'s recommend that the equity returns be based on the most recent litigated proceeding, which results in an equity return of 10.7% and 10.1% respectively.⁴⁵ PECO's equity return was achieved through settlement, which reduced the 11.5% requested in the filing to 10.5%.⁴⁶ However, in Duquesne, the ALJ formulated an entirely new procedure to determine the return on equity.⁴⁷ This recommendation consisted of the following multistep process: (1) the Commission determined equity return in a fully-litigated rate case would be used, providing that the case concluded within three years of the effective date of when Duquesne seeks to update its smart meter costs; (2) the equity from the rate case would then be compared to the equity returns for EDCs in the Quarterly Earnings Report. If there is more than a 0.50% deviation from the Quarterly Earnings Report and litigated rate case equity returns, the lesser of the two would be used for the smart meter equity calculation; and (3) if more than three years has elapsed without a fully litigated rate case, the I.D. recommends that the equity returns for EDCs in the Quarterly Earnings Report be used as a proxy for the

⁴⁵ FirstEnergy I.D., pp. 37-38.

⁴⁶ PECO I.D., p. 22

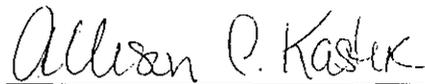
⁴⁷ Duquesne I.D., p. 28.

equity return when determining smart meter cost recovery. Given these inconsistent recommendations in the various smart meter proceedings, there is no uniform method to calculate the cost of common equity in smart meter proceedings. OTS maintains that its recommendation that the cost of common equity be calculated by FUS is consistent with the Commission's current procedure and relies on inputs that are more representative of the current economic conditions in the capital markets.

III. CONCLUSION

For the reasons stated herein, the Office of Trial Staff respectfully requests that the Commission reject the Initial Decision and approve PPL's Smart Meter Plan subject to the modifications presented in the instant Exceptions.

Respectfully submitted,



Allison C. Kaster
Prosecutor
PA Attorney ID #93176

Office of Trial Staff
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-1976

Dated: February 17, 2010

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Installation Plan :

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CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Exceptions** dated February 17, 2010, either personally, by first class mail, electronic mail, express mail and/or by fax upon the persons listed below, in accordance with the requirements of § 1.54 (relating to service by a party):

Anthony D. Kanagy, Esquire
Post & Schell, PC
17 North Second Street
12th Floor
Harrisburg, PA 17101-1601

James A. Mullins, Esquire
Tanya J. McCloskey, Esquire
Office of Consumer Advocate
555 Walnut Street
5th Floor Forum Place
Harrisburg, Pa 17101-1923

Sharon E. Webb, Esquire
Office of Small Business Advocate
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, PA 17101

Kurt E. Klapkowski, Esquire
DEP
RCSOB, 9th Floor
400 Market Street
Harrisburg, PA 17101-2301

Pamela C. Polacek, Esquire
Shelby Linton-Keddie, Esquire
Carl J. Zwick, Esquire
McNees Wallace & Nurick LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108

Harry S. Geller, Esquire
John C. Gerhard, Esquire
PA Utility Law Project
118 Locust Street
Harrisburg, PA 17101-1414

Paul E. Russell, Esquire
PPL Services Corporation
Two North Ninth Street
Allentown, PA 18106

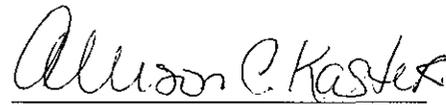
David B. MacGregor, Esquire
Post & Schell, PC
Four Penn Center
1600 John F. Kennedy Boulevard
Philadelphia, PA 19103-2808

David Fein
Constellation Energy Group, Inc.
550 West Washington Blvd. - #300
Chicago, IL 60661

Divesh Gupta
Constellation NewEnergy, Inc.
111 Market Place - #500
Baltimore, MD 21202

Melanie Tambolas, Esquire
Christopher Lewis, Esquire
Blank Rome
One Logan Square
Philadelphia, PA 19103

Honorable Wayne L. Weismandel
Office of Administrative Law Judge
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265



Allison C. Kaster
Allison C. Kaster
Prosecutor
Office of Trial Staff
PA Attorney I.D. #93176

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