BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Docket No. R-2010-2161694

PPL Electric Utilities Corporation

Statement No. 2

Direct Testimony of Mark A. Velicer

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Q. Please state your name and business address.

A. Mark A. Velicer, Two North Ninth Street, Allentown, Pennsylvania 18101.

Q. By whom are you employed and in what capacity?

A. I am employed by PPL Electric Utilities Corporation ("PPL Electric"), a subsidiary of PPL Corporation ("PPL"), as Senior Director, Finance and Regulatory.

Q. What are your duties as Senior Director, Finance and Regulatory?

A. I am responsible for PPL Electric's functional areas of Budgeting and Reporting, Energy Acquisition, and Regulatory Compliance. More specifically, my responsibilities include strategic planning, annual business planning, budget forecasting and management, project prioritization and change control systems, Sarbanes-Oxley (SOX) controls, energy procurement, supplier coordination, customer pricing and tariffs, load research, and load and revenue forecasting.

Q. What is your educational background?

A. I graduated from the University of Illinois with a Bachelors of Engineering in 1988, which I completed at the Technical University of Darmstadt in Germany. Subsequently, I graduated from Cornell with a Masters in Engineering Management in 1990, and from the University of Washington School of Business with a Masters in Business Administration (MBA) in June 2002. My studies focused on economics, systems modeling, operations research, and

business finance. During my work at Cornell, I performed hydropower system optimization for Pacific Gas and Electric. In addition, I completed the Utility Executive Course at the University of Idaho in conjunction with utility representatives from around the country, and have attended several professional seminars and trainings related to best practices in budgeting and planning including the Beyond Budgeting Roundtable and Edison Electric Institute (EEI) Budgeting and Forecasting Seminars.

Q. Please describe your professional experience.

A. I was employed by the Energy and Industrial Business Line at CH2M HILL, from 1990 to 2003. During that tenure I held the roles of Director of the Decision Solutions practice, which focused on the development of decision and risk analytic models for energy and utility clients, and Vice President of the Management and Information Systems (MIS) practice, which included a variety of consulting and information systems services. My responsibilities included performing condition, economic, and financial review of utility systems, long-range infrastructure planning, data center planning, due diligence for mergers and acquisitions, and oversight of the information systems practice. In early 2003, I joined Puget Sound Energy (PSE), an investor-owned, regulated and vertically integrated electric and gas utility based in Bellevue, Washington. My initial position with PSE was as Director, Major Accounts representing the interests of key industrial and commercial customers. Subsequently I assumed the responsibility of Director, Planning and Performance, which included oversight of the electric and gas system planning, engineering, benchmarking,

and budget planning functions related to system operations. Additionally, I led the corporate budgeting and planning function as Director of Planning and Budgeting, including budget planning and oversight for customer services, generation, technology, energy efficiency, and system operations. In mid-2007, I joined PPL Electric as Director of Finance. This position entailed the duties of strategic planning, annual budgeting and planning, budget management, project prioritization systems, SOX controls, benchmarking, and process improvement. In 2008, I assumed my current role as Senior Director, Finance and Regulatory, as described above.

Q. What is the purpose of your testimony?

A. My testimony will describe the derivation of the data used to project the financial results, operating costs, and capital budget for the future test year ending December 31, 2010.

Q. PPL Electric is requesting an increase in electric distribution rates of approximately $115 million annually. Is this requested increase supported by data for a future or experienced test year?

A. PPL Electric primarily will rely on data for a future test year ending December 31, 2010. These data are included in Exhibit Future 1. The Commission's regulations require that a public utility that uses a future test year also must submit data for a historic year, consisting of the twelve months immediately preceding the future test year. As a result, PPL Electric has submitted data for the 12 months ended December 31, 2009. These data are

addressed in testimony provided by Mr. Gary Banzhoff, and set forth in Exhibit Historic 1.

Q. You have stated that the data in Exhibit Future 1 are for the 12 months ending December 31, 2010. This is obviously a projection of future data. Will you please explain the source of this future data?

A. The basic data in Exhibit Future 1 was derived from PPL Electric's budget and forecast figures for the 12 months ending December 31, 2010. I will explain the procedures followed in preparing the Capital and Operating Budgets later in my testimony. In effect, the budget figures take the place of PPL Electric's actual book figures which serve as the basis for the December 31, 2009 data in Exhibit Historic 1.

Q. Mr. Velicer, are you sponsoring any exhibits in this proceeding?

A. Yes, I am sponsoring Exhibits MAV 1 through MAV 5. I also am sponsoring portions of Exhibit Regs., Part I-General Information, Part II-Primary Statements of Rate Base and Operating Income, Part III-Rate of Return, Part V-Plant and Depreciation Supporting Data, Including Related Depreciation Study Report and Part VI-Unadjusted Comparative Balance Sheets and Operating Income Statements.

<u>Exhibits Historic 1 and Future 1</u>

Q. Are you sponsoring any schedules in Exhibits Historic 1 and Future 1?

A. Yes. I am sponsoring the following: Schedules B-1, B-2, B-3, and B-4 of Exhibit Future 1.

Q. Mr. Velicer, would you describe the material presented on Schedules B-1 through B-4 of Exhibit Future 1?

A. Schedule B-1 shows the balance sheet of PPL Electric, excluding all its non-regulated subsidiaries, at December 31, 2010, which includes the assets and liabilities related to the electric utility operations and investments in utility property.

Schedule B-2 provides a statement of electric utility operations showing the operating revenues and expenses and income for the year ending December 31, 2010. Electric operating revenues shown on this schedule are set forth by source in Schedule B-3.

Schedule B-4 provides the operation and maintenance expenses of the electric utility operations by detailed accounts, including the major categories of expense: power production, transmission, regional market, distribution, customer accounts, customer service and informational, sales, and administrative and general. The expenses in the power production category represent the cost of purchased power and include, among other items, purchases to meet Provider of Last Resort ("POLR") requirements, and purchases from non-utility generation companies. Power production costs are not germane to the determination of distribution revenue requirements in this filing, because all expenses in the power production category are related to the purchase of power.

All the data shown in Schedules B-1 through B-4 were taken either from the books and records of PPL Electric, excluding all its non-regulated subsidiaries, or were derived from operating and capital budget data for the 12 months ending December 31, 2010.

Q. Mr. Velicer, can you provide any background on how the future test year financial statements were prepared?

A. The future test year financial statements and data are based on information that PPL Electric used to prepare its 2010 Operating and Capital Budgets. Generally, this unadjusted projected data has been utilized in responding to the Commission's filing regulations.

Q. Has PPL Electric's budgeting process been reviewed by the Commission?

A. Yes. The Commission conducted a Focused Management and Operations Audit of PPL Electric Utilities Corporation, Docket No. D-2009-2102172, in 2008 with recommendations and findings reported in June 2009. With regard to PPL Electric's budgeting processes and systems, the Commission indicated that based on this review PPL Electric's processes are satisfactory, and the audit report had no specific findings or recommendations for changes.

Q. Would you please explain how the capital budget process is carried out by PPL Electric?

A. Yes. At PPL Electric, the annual capital budgeting process is managed and governed by PPL Electric's Finance group (EU Finance). The process begins

early in the year with the planning, evaluation, and prioritization of projects conducted by PPL Electric's Distribution planning team and field engineers. During the first and second quarters, the prior year's circuit performance and winter peak information is evaluated, prior plans are re-evaluated and new projects are proposed to improve future circuit capacity and reliability performance. After this project definition phase, individual capacity and reliability projects, programs and pool items are prioritized using a structured benefit-to-cost evaluation methodology, based on Multi-Attribute Utility Theory and implemented in the Davies Asset Investment System (AIS) software. Some specific categories of capital, such as new customer connections (termed Provide Electric Service or PES) and emergency response (termed Respond To Customers or RTC) are not prioritized against other reliability and capacity projects, rather they are budgeted based on the forecasted demand for those services. The prioritized and budgeted portfolio of projects then is reviewed by PPL Electric's operations and project management teams, and subsequently submitted to EU Finance to enter the general budgeting process. Operation and Maintenance (O&M) related to capital also is estimated (certain capital projects require a component of O&M to implement under FERC accounting rules), the capital budget is entered into the Corporate Budget System, and the portfolio is "labor balanced" to match work requirements with available PPL Electric and contracting resources. This tentative capital budget is reviewed with EU Finance, PPL Electric's management and President, including review of key operational (reliability and system performance) and financial indicators. Subsequently, the capital budget, like the O&M budget as described below, is

reviewed by PPL's Financial Planning and corporate executive teams before review and approval by PPL's Board of Directors. This budget is the key tool used by PPL Electric and its senior management to establish an operating plan for the upcoming year and for measuring actual results against this plan.

Q. Please describe Exhibit MAV 1.

A. Exhibit MAV 1 is a table that summarizes portions of PPL's 2010-2014 Capital Budget which relate to the capital spending needs of PPL Electric. At PPL, a five-year capital budget is prepared annually to identify the capital requirements of the corporation and to establish a basis for financial and manpower planning. Each of the corporation's business lines is responsible for identifying, evaluating, and approving projects for inclusion in its capital budget, and then forwarding all of that data to the Financial Planning Department where the Capital Budget for PPL is reviewed and consolidated.

Q. Please describe the major headings listed on Exhibit MAV 1.

A. The major headings on Exhibit MAV 1 are "Electric Utilities" and "Facilities Management". The section headed "Electric Utilities" summarizes capital requirements related to the distribution system (transmission projects are not included in this table). The section headed "Facilities Management" summarizes capital requirements related to service centers, crew quarters, and office buildings. Supporting the annual amounts shown on Exhibit MAV 1 are lists and databases of projects, schedules for projects, and estimates of project costs. Those lists, schedules, and estimates provide the detailed information

that is the basis of the estimates of property additions and retirements that appear in the Company's response to Question V-A-3 of Exhibit Regs., § 53.53, Part V-Plant and Depreciation Supporting Data, Including Related Depreciation Study Report ("Question V-A-3").

Q. Please describe the categories of expenditures listed in the section of Exhibit MAV 1 headed "Electric Utilities".

A. The categories listed in this section and a description of each is as follows:

1. "Provide Electric Service" includes projects to install new service for residential, commercial, and industrial customers (including service upgrades for existing customers to serve additional load), street lighting additions and modernization, and purchases of distribution transformers. Work in this category is a function of customer requests. Forecasts of capital requirements are based on forecasted economic conditions and projected numbers of new customers.
2. "Upgrade System Facilities" includes specific projects required to ensure and enhance system capacity and reliability. Projects are driven by forecasts of load growth and identified as a result of engineering studies that simulate system loadings under a variety of conditions. Also included in this category are funds for relocations due to highway improvements or other rights-of-way interferences. Forecasts of capital requirements for these last two items are based on recent spending history.
3. "Maintain System Reliability" includes funding for the identification and remedy of deteriorated, obsolete, or failed equipment. Work in this category

is a function of identifying a need as the result of inspection, testing, scheduled replacement, or failure. Forecasts of capital requirements reflect inspection and testing plans, the age of equipment, and previously observed conditions. This category includes items such as distribution pole replacements and reinforcements, underground cable curing and replacements, and other deteriorated or failed equipment replacements.

4. "Improve System Reliability" includes maintenance, engineering, and technology initiatives and programs to improve system performance as measured by SAIFI, CAIDI, multiple outages, and other reliability metrics or standards. This category consists of programs such as new Oil Circuit Reclosers (OCRs), distribution animal guarding, smart grid and specific reliability projects associated with tap fuses, tie lines, voltage regulators, re-conductor lines and relocation of lines from Rights-of-Way,
5. "Asset Optimization Strategy" ("AOS") includes funding to replace worst performing circuits and aging infrastructure due to equipment failure, deteriorated transformers, 12kV interrupting devices, deteriorated copper-weld and copper distribution circuits, and equipment protection and control devices. AOS funding includes additional resources, beyond the Maintain and Improve System Reliability categories described above, that target aging infrastructure based on equipment condition analysis studies to ensure continued reliability performance for customers.

6. “Revenue Cycle Services” includes electric meters for new services. Forecasts of capital requirements are based on the forecast of new customers.
7. “Information Technologies” includes large projects involving the installation of computer software and/or hardware. Forecasts of capital requirements reflect specific identified projects and an allocation based on historical spending levels. The meter data management system described later in my testimony is included here as a specific project.
8. “Vehicles” includes the cost of cars, trucks, and mobile equipment. Forecasts of capital requirements reflect the age of the existing fleet and historical spending levels.
9. “Other” reflects miscellaneous items such as office furniture, tools and equipment, and site acquisitions. Forecasts of capital requirements reflect recent history.
10. “Respond To Customer” includes small projects to resolve customer concerns related to service outages, voltage complaints, street and area lighting problems, property damage, flickering lights, and other concerns. Forecasts of capital requirements are based on recent history.

Q. Please describe the types of expenditures that are budgeted for in the section of Exhibit MAV 1 headed “Facilities Management”.

A. The types of facilities projects budgeted for in this section include replacement projects for equipment that can no longer be maintained and are required for the

continued operation of a building, projects required to provide employees a safe and acceptable work environment, and projects required to meet state and local environmental regulations. Forecasts of capital requirements for Facilities Management are based both on lists of specifically identified needs and on recent history that is trended as appropriate.

Q. Do the capital requirements set forth in Exhibit MAV 1 and the associated property additions and retirements that appear in the Company's response to Question V-A-3 represent, in your opinion, a necessary investment in facilities by PPL Electric?

A. Yes. The capital requirements set forth in Exhibit MAV 1 and the associated property additions and retirements that appear in the Company's response to Question V-A-3 are the result of careful engineering studies extending over many months, and of inspection and testing programs designed to monitor the condition of equipment and to anticipate the need to replace or upgrade it. This forecast of capital requirements reflects PPL Electric's best estimate of the facilities needed to provide reliable and economic delivery service both now and in the future. This forecast also considers the need to provide new and upgraded facilities which are necessary to maintain and, where appropriate, improve the efficiency of operating personnel. I believe that this forecast is reasonable and represents a prudent level of investment.

Q. Would you please explain how the operating budget process is carried out by PPL Electric?

A. Yes. In explaining the budget process, I will be referring to certain exhibits (MAV 2 to MAV 5) which support my direct testimony. During the summer of each year, PPL's Financial Planning group and business line teams, including PPL Electric's Finance team, begin preparing a detailed operating budget for the succeeding calendar year and 5-year planning horizon. Information used in compiling the operating budget generally can be categorized into three major groups: (1) that which is of a specialized nature (e.g., depreciation and amortization, financing, taxes) and generally is supplied by PPL Services Corporation ("PPL Services") staff; (2) that which comes directly from PPL Electric (e.g., employee wages and other operating costs such as materials, contract work, postage, rents); and (3) service group support costs, which are directly assigned and/or allocated to PPL's subsidiaries, including PPL Electric.

In developing specialized information provided by PPL Services' staff, each of the PPL Services groups/departments develops its specific phase of the budget based on its specific experience and expertise. Specialized data from each PPL Services' staff group is coordinated with other staff groups requiring this information in order to complete this phase of the budgeting process. For example, depreciation and interest expense information is needed for the tax budget to be completed.

Each of PPL Electric's responsibility centers develops its own O&M budget and forwards it to the EU Finance group, which then summarizes the budgets in the Corporate Budget System and presents them for review and

approval by PPL Electric's executive management. After executive management and the President approves the draft budget, the data is released to Financial Planning, where the data is incorporated into the overall PPL Electric operating budget.

In developing service group support costs for PPL Electric, each PPL Services group computes the level and expected cost of providing identifiable services (direct costs) to PPL Electric based on discussions of required services between the support group and PPL Electric personnel. The PPL Services groups enter these direct support costs into the Corporate Budget System. Additionally, the service groups identify and enter into the Corporate Budget System budgeted costs that are not directly identifiable and chargeable to a specific PPL subsidiary, but instead benefit various PPL subsidiaries (indirect costs). Financial Planning has developed and incorporated into the Corporate Budget System an allocation methodology, as recommended by the Commission in its 2002 Focused Management and Operations Audit, to distribute these indirect support costs to PPL Electric and other PPL subsidiaries. The Corporate Budget System accumulates and incorporates all the direct and indirect support costs into PPL Electric's Operating Budget.

After the final pieces of the budget are incorporated from all three groups discussed above and approvals have been obtained, a tentative operating budget is prepared for PPL Electric. The tentative budget is reviewed with executive management and the President, including review of key operational and financial indicators. After this review, the final budget is prepared and reviewed with the Board of Directors of PPL Electric. This budget is the key

tool used by PPL Electric and senior management to establish an operating plan for the upcoming year and for measuring actual results against this plan.

Q. You stated that certain specialized data for the budget are provided by PPL Services' staff groups. Could you tell us specifically what data are provided, and who provides this data?

A. Yes. Exhibit MAV 2 lists the specialized information used in completing the operating budget and identifies the specific PPL Services' staff groups responsible for providing that data.

Q. You also stated that the remaining data for the operating budget comes from responsibility centers. What are responsibility centers, and how many responsibility centers does PPL Electric have?

A. The PPL Electric organization is broken down into three major business units, Customer Services, Operations, and Finance, and two additional business units, including the President and Regulatory Strategy. Each business unit is subdivided into functional groups referred to as responsibility centers. Each responsibility center has an assigned manager who is responsible for all costs incurred by that responsibility center. Each employee is assigned to a particular responsibility center. PPL Electric has 105 active responsibility centers, including the major business units and their sub responsibility centers. Exhibit MAV 3 contains a list of the responsibility centers providing data for the 2010 Operating Budget.

Q. What type of data do they provide?

A. Each responsibility center provides a projection of its employee levels for the year that becomes the basis for projecting total wages and salaries. The responsibility centers also provide a budget of their other operating costs.

Q. Could you explain how the budget for wages is determined?

A. Yes. Early in the summer, Financial Planning notifies the business line affiliates of the "Date of Estimate", which is the starting point date at which the Corporate Budget System determines the number of employees, and their associated wages, in each responsibility center. Any changes from the Date of Estimate starting point, including new hires, decreases due to retirements or work force reductions and changes in salary levels must be identified. Employee levels are reviewed and approved in conjunction with the overall budget review.

The Corporate Budget System automatically calculates a budget for wages based on the starting level of employees and their actual earnings and the employee changes input. The system then applies assumed management and bargaining unit wage changes, and also loads the wages with employee benefits costs.

As business units budget for their employee levels, they generally allocate their available manpower by functional activity. As part of this process, they designate the applicable accounting to be charged-- capital or expense. Wages identified as expense ultimately appear on Schedule B-2 of Exhibit Future 1, PPL Electric’s income statement, as an O&M expense.

Q. You mentioned the budget for other operating costs. What costs fall into this category?

A. The Corporate Budget System requires budgeting by category of expenditure referred to as budget items. Exhibit MAV 4 is a list of PPL Electric's various budget items.

Q. How are these budget items estimated?

A. Non-payroll requirements, such as rents, materials and contractors, generally are entered by budget item and functional activity, and in the month or months the expenses are anticipated to occur. Budgets for payroll and non-payroll budget items are summarized by department for review following the process described above.

Q. As part of the future test year data in the present rate filing, budget expenditures have been provided by account. Do the departments also budget by FERC account?

A. No. The budget is created by category of expenditure (budget items listed in Exhibit MAV 4) and sometimes by functional activity. PPL believes that it is more meaningful to budget and monitor expenditures by category of expense (e.g., payroll, employee expenses, material and supplies) than by FERC accounts. However, to satisfy the requirements for this rate case filing, PPL Electric has allocated expenditures into FERC accounts. This was accomplished by first allocating O&M costs budgeted by category of

expenditures to FERC accounts where the budget classification specifically was identifiable to those accounts. For those budget classifications not identifiable to a specific FERC account, the total remaining budgeted expenditures were allocated to FERC accounts based on the same relationship to the total as the actual costs shown for the operation and maintenance expenditures incurred in the historic test year ended December 31, 2009, which are reported by both budget classification and FERC account.

Q. How was the operating budget used in this rate case filing?

A. The operating budget was used as the basis for forecasting PPL Electric's Operating Income for the test year ending December 31, 2010. See the response to Question II-E-1 of Exhibit Regs., § 53.53, Part II, Primary Statements of Rate Base and Operating Income ("Question II-E-1"). The forecasted data shown in the response to Question II-E-1 was reformatted to correspond to FERC account classifications and is shown in Schedule B-2 of Exhibit Future 1 and throughout PPL Electric's responses to the Commission's filing regulations.

Q. Are you aware of the requirement that a comparison of actual to budget data is to be supplied quarterly when a utility utilizes a future test year?

A. Yes. In preparation for complying with this requirement, Exhibit MAV 5 has been provided. This exhibit shows a breakdown of revenues and expenses for electric operations for the future test year into calendar quarters beginning in January of 2010 and ending December of 2010. PPL Electric will provide

quarterly comparisons of actual results to the budget as shown in Exhibit MAV 4 as the actual data becomes available.

Q. Does this conclude your direct testimony?

A. Yes, it does.