

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-2010-2161694**

**PPL Electric Utilities Corporation**

**Statement No. 7**

**Direct Testimony of Joseph M. Kleha**

1 **Direct Testimony of Joseph M. Kleha**

2 **Q. Please state your full name and business address.**

3 A. Joseph M. Kleha, Two North Ninth Street, Allentown, Pennsylvania, 18101.

4

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

6 A. I am employed by PPL Electric Utilities Corporation ("PPL Electric"), a  
7 subsidiary of PPL Corporation, as Manager - Regulatory Compliance and  
8 Rates. I assumed this position on January 12, 2009.

9

10 **Q. What are your duties as Manager - Regulatory Compliance and Rates?**

11 A. I am responsible for PPL Electric's compliance with the regulatory  
12 requirements of the Pennsylvania Public Utility Commission ("PUC" or the  
13 "Commission"), the Federal Energy Regulatory Commission ("FERC") and  
14 other regulatory agencies, as necessary. As part of this function, I am  
15 responsible for the preparation and review, and technical oversight and  
16 guidance, of the development, content and structure of cost allocation and  
17 revenue requirement studies. In addition, I am responsible for all aspects of  
18 PPL Electric's rates, tariffs, load research, and load and revenue forecasting. I  
19 also prepare and present expert testimony regarding these and other cost-of-  
20 service and ratemaking-related issues.

21

22

23

1 Q. **What is your educational background?**

2 A. I graduated from The Pennsylvania State University in May 1974 with a  
3 Bachelor of Science Degree in Accounting. Since that time, I have taken  
4 specialized courses dealing with public utility accounting, depreciation and rate  
5 design. In addition, I attended the National Association of Regulatory Utility  
6 Commissioners' ("NARUC") Regulatory Studies Program.

7  
8 Q. **Please describe your professional experience.**

9 A. I was employed by the Pennsylvania Department of Public Welfare as Field  
10 Auditor and Institutional Collections Officer from 1974 to 1977. In 1977, I  
11 joined the technical staff of the Pennsylvania Public Utility Commission  
12 ("PUC") as a Utility Rate Analyst in its Bureau of Rates and Research. In this  
13 position, my responsibilities included review of proposed retail electric rate  
14 filings, and the preparation and presentation of testimony in formal rate  
15 proceedings. This testimony primarily dealt with the allowable levels and  
16 jurisdictional allocations of claimed operating revenues, operating expenses,  
17 and rate base. In 1981, I joined PPL Electric, formerly Pennsylvania Power &  
18 Light Company, as a Senior Accountant with responsibility for assembling  
19 financial data and preparing revenue requirement studies to support its retail  
20 and wholesale rate filings. I was named Manager - Regulatory Projects in PPL  
21 Electric's Office of General Counsel in 1990. In 2000, as part of a corporate  
22 realignment, I became an employee of PPL Services Corporation, along with

1 the other employees in the Office of General Counsel. In 2009, I assumed my  
2 current position with PPL Electric.

3

4 Q. **Have you previously testified as a witness on cost-of-service and**  
5 **ratemaking-related issues?**

6 A. Yes, I have testified before this Commission and the Federal Energy  
7 Regulatory Commission ("FERC") in numerous proceedings regarding cost-of-  
8 service and ratemaking-related issues. See Appendix A for a list of those  
9 proceedings. In addition, I have testified regarding cost-of-service and  
10 ratemaking-related issues before the United States Tax Court at Docket No.  
11 25393-07.

12

13 Q. **Mr. Kleha, briefly describe the subject matter of your testimony in this**  
14 **proceeding.**

15 A. My testimony and accompanying exhibits describe and support PPL Electric's  
16 calculation of certain ratemaking adjustments to the historic test year and  
17 future test year retail rate base, operating revenues and operating expenses;  
18 the development of the cost allocation studies which form the basis for  
19 proposed retail rates; the determination of jurisdictional investment and  
20 expense (capital and operating costs) and revenue requirements, and the  
21 derivation of the retail cost of providing distribution service by customer rate  
22 class. In addition, my testimony addresses PPL Electric's proposed Purchase  
23 of Receivables ("POR") program and Merchant Function Charge ("MFC").

1 Q. **Mr. Kleha, are you sponsoring any exhibits in this proceeding?**

2 A. Yes. I am sponsoring Exhibits JMK 1, JMK 2, JMK 3, JMK 4 and JMK 5. I  
3 also am sponsoring portions of Exhibit Regs., Part 1-General Information, Part  
4 II-Primary Statements of Rate Base and Operating Income, Part IV-Rate  
5 Structure and Cost Allocation, and Part V-Plant and Depreciation Supporting  
6 Data, Including Related Depreciation Study Report.

7

8 Exhibits Historic 1 and Future 1

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

10 A. Yes. I am sponsoring the following: Schedules B-5, C-1, C-3, C-4, C-6, D-1,  
11 D-2, D-6, D-8, D-10, D-11, D-12 and D-13 of Exhibits Historic 1 and Future 1.

12

13 Q. **Schedules C-4 of Exhibits Historic 1 and Future 1 show details of PPL  
14 Electric's claim for cash working capital. Would you explain these  
15 schedules?**

16 A. Schedules C-4 of Exhibits Historic 1 and Future 1 are computations of PPL  
17 Electric's average investment in cash working capital. There are five major  
18 components in this computation: cash working capital required for operation  
19 and maintenance ("O&M") expenses; funds invested in prepayments; an  
20 adjustment for accrued taxes; an adjustment for interest payments; and an  
21 adjustment for preferred dividend payments.

22

23

1 Q. **Would you explain these five components?**

2 A. Page 2 of Schedules C-4 shows the first component, which is cash working  
3 capital required for O&M expenses. PPL Electric bills all of its customers once  
4 every month, but the due date for payment varies between 15 and 30 days  
5 from the billing date. On this basis, there is a considerable span of days  
6 between the time electricity is furnished to a customer and the time the  
7 customer pays for such electricity. This span averages 34 days for customers  
8 with 15-day due dates, 59 days for customers with 20-day due dates, and  
9 43 days for customers with 30-day due dates. The average lag in receipt of  
10 revenues from all these sources is 49.3 days on a dollar-weighted basis.

11 In most instances, PPL Electric must pay its bills for payroll, employee  
12 benefits, support group costs and other operating expenses prior to the time it  
13 is able to collect the amount due for the service giving rise to these expenses.  
14 PPL Electric has examined its records to determine, as to the major categories  
15 of expense, the average span of days between the time an expense is  
16 incurred and the time it must be paid. On page 2 of Schedule C-4 of Exhibit  
17 Historic 1, the average span of days for major categories of expense is shown.  
18 This lag ranges from 12 days to 35 days for various types of costs. The  
19 overall average for all expenses is 28.0 days. Thus, the average net lag  
20 between the payment of expenses and the receipt of the related revenue is  
21 21.3 days (49.3 days less 28.0 days). To cover its expenses and continue to  
22 conduct its business during this time lag, PPL Electric must provide a cash  
23 investment.

1           The second major component of cash working capital is made up of  
2 funds which are invested in prepayments. This amount is shown on page 3 of  
3 Schedules C-4. In conducting its electric business, PPL Electric must pay  
4 certain costs prior to the time such items are properly charged to expense for  
5 accounting and ratemaking purposes. For example, the PUC's annual  
6 assessment must be prepaid, but is expensed monthly over the period to  
7 which it applies. Costs of this nature initially are charged to FERC Account  
8 165, Prepayments, and subsequently are charged to expense from this  
9 account.

10           The claim for prepaid expenses is based on the 13-month average of  
11 the various items included in Account 165. This amount has been claimed as  
12 a component of cash working capital for both the historic test year and future  
13 test year.

14           The third major component of cash working capital is the adjustment for  
15 accrued taxes, which is shown in detail on page 4 of Schedules C-4. In the  
16 case of Federal income tax, estimated payments must be made on April, June,  
17 September and December 15 of the year to which the tax is applicable.  
18 Because revenues are collected from customers monthly, there are funds  
19 temporarily available for payment of other costs. PPL Electric's computations  
20 indicate that funds available from this source average 3.77% of the federal  
21 income tax due.

22           Presently, the Pennsylvania income tax and Pennsylvania Capital Stock  
23 Tax have the following pattern of required estimated payments:

- 1           • 25% on March 15
- 2           • 25% on June 15
- 3           • 25% on September 15
- 4           • 25% on December 15

5           PPL Electric's computations indicate that the funds available from these taxes  
6           average 1.68% of the tax due.

7                     The Pennsylvania gross receipts tax must be paid on an estimated  
8           basis by March 15 of the year to which the tax is applicable. Because revenue  
9           is collected from customers monthly, funds must be provided by investors to  
10          pay these taxes prior to the collection revenues from customers. PPL  
11          Electric's computations indicate that the funds which must be provided for this  
12          purpose average 35.82% of the tax due. This adjustment is based on the total  
13          Pennsylvania gross receipts tax which must be paid at the 59 mill rate actually  
14          in effect.

15                    The Pennsylvania Public Utility Realty Tax must be paid on an  
16          estimated basis by May 1 of the year to which the tax is applicable. Because  
17          revenue is collected from customers monthly, funds must be provided by  
18          investors to pay these taxes prior to the collection from customers. PPL  
19          Electric's computations indicate that funds which must be provided for this  
20          purpose average 23.32% of the tax due.

21                    The net effect of these various accrued tax adjustments is an increase  
22          in PPL Electric's cash working capital requirement as shown on page 4 of  
23          Schedules C-4.

1           The fourth and fifth components of cash working capital are offsetting  
2 adjustments for the funds applicable to debt interest payments and preferred  
3 stock dividend payments, which are shown on pages 5 and 6 of Schedules  
4 C-4. PPL Electric “theoretically” has unrestricted use of these funds from the  
5 time of the monthly collection from customers until the payment of interest and  
6 dividends on a semi-annual or quarterly basis. PPL Electric does not agree  
7 with the appropriateness of such a reduction to the Measures of Value.  
8 However, this adjustment has been made in order to facilitate the adjudication  
9 of this filing and in compliance with the Commission's current policy.

10  
11 **Q. What is shown on Schedules C-6 of Exhibits Historic 1 and Future 1?**

12 **A.** Schedules C-6 of Exhibits Historic 1 and Future 1 reflect the balances of  
13 deferred income taxes at the end of the respective test years, including the tax  
14 deferrals related to Accelerated Cost Recovery System (“ACRS”) and Modified  
15 Accelerated Cost Recovery System (“MACRS”) property. The applicable  
16 ACRS/MACRS legislation provides for mandatory normalization of federal tax  
17 benefits on post-1980 property. Accordingly, PPL Electric has claimed federal  
18 income tax normalization associated with ACRS/MACRS-related property in  
19 this filing, as well as the balances of deferred income taxes associated with  
20 Contributions In Aid of Construction ("CIAC"), and repair allowance and other  
21 Section 263 A costs related to ACRS/MACRS property.

22

1 Q. **Why aren't Accumulated Deferred Investment Tax Credits (FERC**  
2 **Account 255) reflected in the computation of the Measures of Value?**

3 A. Under provisions of the Revenue Act of 1971, public utilities were afforded the  
4 option of treating the investment tax credit in rate proceedings by reducing  
5 taxes over the life of the property and not deducting the accumulated amount  
6 of the credit from the Measures of Value.

7 On March 8, 1972, PPL Electric made this election as provided for  
8 under the Internal Revenue Code, Section 46(e), Paragraph (2), and, in  
9 compliance therewith, has not reduced the Measures of Value for the purpose  
10 of these proceedings. However, such credits are being amortized as an  
11 annual credit to operating expense over the life of the related property.

12

13 Q. **Please explain the "Adjustment to Taxes Other Than Income Taxes"**  
14 **shown on Schedules D-10 for both the historic and future test years.**

15 A. In order to derive the current level of Pennsylvania Capital Stock Tax, the  
16 valuation method used by the Pennsylvania Department of Revenue was  
17 utilized. This results in an estimated valuation at December 31, 2009 and  
18 December 31, 2010. The 2.89 mill tax rate is applied to the valuation to derive  
19 the total capital stock tax liability at December 31, 2009 under present rates.  
20 The 2.89 mill tax rate also is applied to the valuation to derive the total capital  
21 stock tax liability at December 31, 2010 under present rates. This portion of  
22 the computation is set forth on Schedules D-10, page 2. From this amount is  
23 deducted the capital stock tax expense per books for the 12 months ended

1 December 31, 2009, and the expense per budget for the 12 months ending  
2 December 31, 2010. This adjustment reflects both the current taxable  
3 valuation and the applicable tax rates.

4

5 Q. **Please explain the Pennsylvania Gross Receipts Tax shown on**  
6 **Schedules D-10.**

7 A. The adjustment to Pennsylvania Gross Receipts Tax is shown on Schedules  
8 D-10, page 3. This adjustment reflects the gross receipts tax liability changes  
9 which will result from base rate revenues generated by the annualization of  
10 sales under present rates.

11

12 Q. **Please explain the adjustment for Pennsylvania Public Utility Realty Tax.**

13 A. The Pennsylvania Public Utility Realty Tax is developed under present rates  
14 based on the plant in service at December 31, 2009 and projected to be in  
15 service at December 31, 2010. From this amount is deducted the tax expense  
16 per books for the 12 months ended December 31, 2009, and the tax expense  
17 per budget for the 12 months ending December 31, 2010.

18

19 Q. **Please explain the adjustment of federal and state income taxes, shown**  
20 **on Schedules D-11 for both test years.**

21 A. Schedules D-11 show, in column 1, the tax computation as recorded for the 12  
22 months ended December 31, 2009, and as budgeted for the 12 months ending  
23 December 31, 2010. Column 2 shows adjustments required to exclude

1 revenues, expenses and income tax adjustments associated with Provider of  
2 Last Resort ("POLR") generation supply service; the collection of and/or the  
3 refund/recoupment of over/under collected stranded costs through the  
4 Competitive Transition Charge ("CTC"); the recovery of transmission service  
5 costs through the Transmission Service Charge ("TSC"); the recovery of non-  
6 distribution-related uncollectible accounts expense through the Merchant  
7 Function Charge ("MFC"); the recovery Energy Efficiency Plan costs through  
8 the Act 129 Compliance Rider ("ACR"); and the recovery of universal service  
9 costs associated with the Company's OnTrack and WRAP programs through  
10 its Universal Service Ride ("USR"). Column 3 shows the derivation of the  
11 revenues, expenses and tax adjustments for PPL Electric's combined  
12 transmission and distribution ("T&D") operations only. Column 4 shows the  
13 various adjustments for a proper computation of taxable income on a pro  
14 forma basis at present rates. Column 5 shows the pro forma income tax  
15 computation at present rates.

16 Taxable income and the tax computations are adjusted in Column 4 for  
17 the following reasons:

- 18 • To reflect the effect on taxable income of adjustments to revenue  
19 and expense set forth on Schedules D-2 and to reflect other  
20 changes in taxable income.
- 21 • To eliminate the effect of prior year tax adjustments and provisions  
22 for possible tax deficiencies recorded on the books for the 12

1 months ended December 31, 2009, or reflected in the budget for  
2 the 12 months ending December 31, 2010.

- 3 • To reflect the effect of a consolidated tax savings adjustment.

4

5 Q. **Are there several tax adjustments upon which you wish to elaborate?**

6 A. Yes. They are the following:

7 Tax Depreciation

8 In general, depreciation for tax purposes must be computed using the  
9 tax basis of the property (which generally is lower than book basis) and using  
10 various depreciation methods and rates which differ from those used in  
11 computing book depreciation.

12 In computing tax depreciation, this filing parallels the methods used in  
13 PPL Electric's prior base rate proceedings and its Federal and Pennsylvania  
14 income tax returns. That is, for property acquired after 1980, PPL Electric  
15 uses the Accelerated Cost Recovery System ("ACRS"), as provided for in the  
16 Economic Recovery Tax Act of 1981, and the Modified Accelerated Cost  
17 Recovery System ("MACRS"), as provided for in the Tax Reform Act of 1986.  
18 In addition, PPL Electric adopted the broader concept of "unit of property"  
19 related to its ACRS/MACRS property. As a result, those components of  
20 property that are "functionally interdependent" can be considered to be a unit  
21 of property and, as such, certain expenditures for repairs to this property can  
22 be deducted for tax purposes.

23

1        Annualized Interest

2                This adjustment is the result of normalizing the interest deduction based  
3        on the test year measures of value, as shown on Schedules D-11, page 3.  
4        Because customers pay a return on only these measures of value, it is only  
5        the interest associated with these measures of value that applies to PPL  
6        Electric's T&D operations for ratemaking purposes.

7  
8    Q.    **Please summarize the effects of these tax adjustments.**

9    A.    Recognition of all tax adjustments reflected on Schedules D-11 results in a net  
10       decrease in taxable income for the historic and future test years. Taxable  
11       income is the basis for computing both federal and Pennsylvania income  
12       taxes.

13                The actual Pennsylvania Corporate Net Income Tax rate is 9.99%. The  
14       federal income tax is computed at the current 35% tax rate. For federal  
15       income tax purposes, the amount of Pennsylvania income tax is an allowable  
16       deduction. Details of the computations of all taxes incurred as a result of the  
17       proposed revenue increase are shown on Schedules D-11, page 5.

18  
19    Q.    **Please explain Schedules D-12, "Adjustments to Deferred Income  
20       Taxes," for both test years.**

21    A.    Normally, deferred taxes arise in connection with expenses which, for various  
22       reasons, are recorded on the books as an expense in a different year than the  
23       same item is allowed as an income tax deduction. This is referred to as a

1 book/tax timing difference. Generally accepted accounting principles  
2 (“GAAP”), which are prescribed by the Financial Accounting Standards Board  
3 (“FASB”), require that the tax savings related to an expense item be recorded  
4 on the books at the same time as the expense item is recorded. For example,  
5 if the expense item is booked in a year after its deductibility for tax purposes, a  
6 deferred tax charge is recorded on the income statement and a liability for  
7 such tax is recorded on the balance sheet in the year the tax deduction  
8 occurs. The same basic principle applies to revenue items, as well as  
9 expense items.

10 Schedules D-12 show the normalization of the net deferrals recorded  
11 on the books for the 12 months ended December 31, 2009, and as budgeted  
12 for the 12 months ending December 31, 2010.

13 It should be noted that for the year ended December 31, 2009, and the  
14 year ending December 31, 2010, the specific items covered by deferred taxes  
15 all arise in connection with timing differences, as discussed above. Certain  
16 items require adjustment for purposes of this rate filing. The major adjustment  
17 in the historic and future test years relates to the ACRS/MACRS system of tax  
18 depreciation, as set forth on Schedules D-12, page 2.

19 Regarding Schedules D-12, PPL Electric uses ACRS/MACRS in  
20 computing tax depreciation on post-1980 property additions. Schedules D-12  
21 reflect an adjustment for the mandatory deferral of the federal income tax  
22 effects of ACRS/MACRS based on the tax plant balances at December 31,  
23 2009 and December 31, 2010. Schedules D-12 also reflect the deferral of

1 income taxes associated with CIAC, repair allowance and other Section 263 A  
2 costs related to ACRS/MACRS property.

3  
4 Q. **Please explain Schedules D-13.**

5 A. Schedules D-13 adjust the amortization of the investment tax credit to reflect a  
6 full year's amortization based on the unamortized investment tax credit  
7 remaining at December 31, 2009 and December 31, 2010, respectively.

8  
9 Consolidated Tax Savings

10 Q. **Has PPL Electric included a consolidated tax savings adjustment in this  
11 proceeding?**

12 A. Yes, PPL Electric has included a consolidated tax savings adjustment that  
13 reduces its claimed Federal Income Tax expense by \$2.4 million in the future  
14 test year ending December 31, 2010.

15  
16 Q. **What are your views on allocating the tax savings of unregulated affiliate  
17 company tax losses to utility operations for the purposes of setting the  
18 level of electric distribution service rates?**

19 A. In general, the allocation of tax loss deductions of unregulated affiliate  
20 companies to an affiliated utility business is contrary to sound ratemaking  
21 principles. One of those principles is that a utility's revenue requirement and  
22 the associated customer rates should be established on the basis of the  
23 utility's normal, ongoing operations on a stand-alone basis.

1           When none of the risks of the unregulated affiliates are assumed by the  
2 customers of the regulated utility, neither the Commission nor the Courts  
3 should have the ability to appropriate the losses generated in those  
4 unregulated affiliates to reduce the utility's cost of service. When losses do  
5 occur, for whatever reason, the consolidated tax return should afford some  
6 relief to the entities incurring the tax losses in the current period.

7           To deprive the unregulated affiliate of a business-loss tax deduction is  
8 to take away a valuable property right belonging to that entity, and represents  
9 a use of unregulated assets for regulated purposes. To base the revenue  
10 requirement and associated rates of a utility on the tax losses of unregulated  
11 affiliates, which vary from one year to the next as the activities of a diversified  
12 group of affiliated companies fluctuate, certainly is contrary to the sound  
13 ratemaking principles regarding the separation of regulated and unregulated  
14 operations (investment, revenues and expenses), and the normalization of a  
15 utility's test year operations (revenues and expenses, including taxes) for  
16 purposes of establishing the utility's normal and ongoing revenue requirement.

17           Despite this philosophical disagreement, I recognize that the  
18 Commission has adopted consolidated tax savings adjustments in other  
19 proceedings and the Pennsylvania Supreme Court has mandated this  
20 approach. Accordingly, PPL Electric has included a consolidated tax savings  
21 adjustment in this proceeding.

22

1 Q. **How has PPL Electric determined its consolidated tax savings**  
2 **adjustment in this proceeding?**

3 A. As shown on page 4 of Schedules D-11, PPL Electric has based its calculation  
4 of this adjustment on a 3-year average of the consolidated tax savings  
5 generated by PPL Corporation, PPL Electric's parent company, and its  
6 unregulated subsidiaries over the most recently available tax years, 2007  
7 through 2009. The rationale for using the filed returns for this 3-year period to  
8 calculate the tax savings amount generated by the "tax loss" affiliates, and  
9 PPL Electric's allocated share of those savings, is to provide an average level  
10 of consolidated tax savings as the starting point for calculating the adjustment.

11

12 Q. **Has PPL Electric made any adjustments to the taxable income data**  
13 **associated with its "tax loss" affiliates for this 3-year period?**

14 A. Yes. In order to determine the proper level of affiliate tax losses, PPL Electric  
15 excluded from its calculations the non-recurring items which contributed to  
16 those affiliate losses. In accordance with Commission practice and precedent,  
17 non-recurring items should be excluded from the calculation of future test year  
18 income tax expense, and consolidated tax savings adjustments thereto. A  
19 significant portion of the tax losses incurred by PPL Electric's affiliate, PPL  
20 Energy Funding Corporation, were due to the following non-recurring items.

21 (1) Non-recurring bonus tax depreciation – The Internal Revenue Code  
22 ("IRC") allowed a 30-50% tax depreciation deduction for property placed

1 into service prior to January 1, 2005, and between January 1, 2008 and  
2 December 31, 2009. This provision of the Code has expired.

3 (2) One-time losses resulting from the retirement/abandonment of the two (2)  
4 coal-fired units at Martins Creek SES, which, by definition, are non-  
5 recurring.

6 (3) Losses from discontinued operations – The assets of PPL Shoreham and  
7 PPL Edgewood in New York, and PPL Maine in Maine, were sold. In  
8 addition, the synfuel operations at PPL Avon Lakes and PPL Somerset  
9 were dissolved. Any gains or losses associated with the sale or  
10 dissolution of these assets, by definition, are non-recurring.

11 (4) Section IRC 481 adjustment refers to the IRC section that prescribes the  
12 tax year in which taxable income resulting from a change in tax  
13 accounting method must be recognized. The method change associated  
14 with the accounting for repair expense/unit of property is specifically  
15 related to prior period tax returns and, as such, is not expected to recur.

16 In addition, PPL Electric adjusted its taxable income for the 3-year period 2007  
17 through 2009 to eliminate that portion of taxable income associated with its  
18 non-regulated subsidiaries, as well as non-recurring items, e.g., bonus tax  
19 depreciation.

20  
21 Exhibits JMK 1, JMK 2, JMK 3 and JMK-4

22 Q. **Please explain how PPL Electric's Pennsylvania jurisdictional costs are**  
23 **derived.**

1 A. This filing is based on the investment and expense incurred to provide  
2 distribution service to PPL Electric's Pennsylvania jurisdictional customers.  
3 Accordingly, PPL Electric's historic test year per books and future test year per  
4 budget delivery service operating results are adjusted to eliminate all revenues  
5 and expenses associated with the generation function, namely POLR service  
6 and the recovery and/or refund/recoupment of over/under collections of  
7 stranded costs through the CTC, which was approved by the Commission in  
8 PPL Electric's restructuring proceeding at Docket No. R-00973954, as well as  
9 the TSC, MFC, ACR, USR and other cost recovery mechanisms, to derive the  
10 combined T&D operations. T&D investment and expense then are assigned  
11 between the Federal (transmission) and Pennsylvania (retail distribution)  
12 jurisdictions. Exhibits JMK 1 and JMK 2 provide specific details regarding the  
13 assignment and allocation of those costs and the determination of the  
14 Pennsylvania jurisdictional distribution service revenue requirements on a  
15 system and rate class basis.

16  
17 Q. **Would you briefly describe the contents of Exhibits JMK 1 and JMK 2?**

18 A. Exhibits JMK 1 and JMK 2 respond to Question 1 of Exhibit Regs., Part IV,  
19 Section E, and present fully distributed Pennsylvania jurisdictional costs of  
20 providing retail distribution service to the various rate classes at both present  
21 and proposed rates. The studies contained in Exhibit JMK 1 are based on  
22 costs and operating conditions for the historic test year ended December 31,  
23 2009. The studies contained in Exhibit JMK 2 are based on costs and

1 operating conditions for the future test year ending December 31, 2010. The  
2 objective has been to make each exhibit a self-contained document. Each  
3 exhibit provides a summary of the results, a printout of the cost assignment  
4 and allocation detail, and supporting schedules showing functionalization of  
5 the costs and support for the cost allocation factors used. Explanatory  
6 material with regard to methods employed and cross-referencing to Exhibits  
7 Historic 1 and Future 1, as applicable, also are included.

8  
9 Q. **What cost assignment and allocation method was utilized in your**  
10 **studies?**

11 A. The cost allocation studies, which are set forth in Exhibits JMK 1 and JMK 2,  
12 generally follow the same principles utilized by PPL Electric for over thirty  
13 years, including in its restructuring filing at Docket No. R-00973954 and its  
14 most recent base rate case at Docket No. R-00072155. That is, PPL Electric  
15 continues to utilize the class maximum non-coincident peak ("NCP") demand  
16 method, which is based on the highest demand imposed by each rate class on  
17 its distribution system, to allocate its demand-related distribution costs.  
18 Section V of Exhibit JMK 1 and Section VI of Exhibit JMK 2 present the results  
19 of studies using other demand allocation methods, as required by Question 1  
20 of Exhibit Regs., Part IV, Section E.

1 Q. **Please describe the distribution plant investment studies contained in**  
2 **Exhibit JMK 3.**

3 A. Exhibit JMK 3 contains the results of two studies: (1) the subfunctionalization  
4 of distribution plant investment and expense into primary and secondary  
5 voltage level components and the classification of those components into  
6 customer and demand-related costs, and (2) the development of allocators for  
7 meter investment and meter reading expense, which are used in the historic  
8 and future test year cost allocation studies provided in Exhibits JMK 1 and  
9 JMK 2. It should be noted that the subfunctionalization and classification of  
10 distribution plant investment and expense is based on a detailed analysis of  
11 specific PPL Electric plant records and cost data. The methodologies  
12 employed in the studies are explained in Exhibit JMK 3 and the results of  
13 these studies are reflected in Sections A and B of Exhibits JMK 1 and JMK 2.

14  
15 Q. **In classifying its distribution plant investment and expense into**  
16 **customer and demand-related costs, has PPL Electric used the same**  
17 **methodology as that used in its last retail base rate case?**

18 A. Yes. Consistent with the approach used in its most recent retail base rate  
19 case and prior cases, PPL Electric believes that it is appropriate to continue  
20 the use of the “minimum size system” methodology to identify the applicable  
21 customer and demand-related cost components to determine the current cost  
22 of the “minimum size” distribution system necessary to provide reliable  
23 distribution service to its customers.

1  
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**Q. Has PPL Electric made any modifications to its “minimum size system” methodology since its most recent base rate case at Docket No. R-00072155?**

A. Yes, it has. In previous base rate proceedings, several parties criticized PPL Electric’s proposed “minimum size system” studies based on the assertion that a portion of the “minimum size” equipment classified as customer-related in those studies, e.g., overhead and underground transformers, had significant load-carrying capability, which should have been classified as demand-related, rather than customer-related.

As a result, in an effort to add more precision to the classification of its distribution facilities into their customer-related and demand-related components, PPL Electric undertook a rigorous engineering analysis of the “minimum size” overhead (10 KVA) and underground (25 KVA) transformers, which currently are being installed on its system, to identify the customer-related “minimum or no load” portion of that equipment. This analysis, which was based on the Capitalized Cost Method, identifies the total “owning cost” for transformers that consists of the cost of the transformer (canister, windings, bushings, etc.), the cost of core (no load) losses, and the cost of load losses. The results of this analysis, which have been applied to PPL Electric’s overhead and underground transformers, provide a more precise classification of those distribution facilities into their customer-related and demand-related components, as shown in Exhibit JMK 3. Accordingly, only the “minimum or

1 no load” portion of PPL Electric’s overhead and underground transformers has  
2 been classified as customer-related in this proceeding; the remaining portion  
3 of those facilities has been classified as demand-related.

4 In addition, PPL Electric has, for the first time, sub-functionalized its  
5 substation equipment investment into the applicable primary and secondary  
6 voltage level components. These components, as well as those for the  
7 Company’s primary voltage level overhead and underground lines, then were  
8 classified into their customer-related and demand-related costs, as shown in  
9 Exhibit JMK 3. The "minimum size" substation transformers (10 MVA), which  
10 currently are being installed on PPL Electric's system, also were analyzed to  
11 determine the "minimum or no-load" portion that has been classified as  
12 customer-related.

13  
14 Q. **Mr. Kleha, is the preparation of a cost allocation study an exact science?**

15 A. No, it is not. The fundamental purpose of a cost allocation study is to aid in  
16 the design of rates to be charged by identifying all of the capital and operating  
17 costs incurred by a utility to provide service to all of its customers, and then  
18 assigning or allocating those costs to individual rate classes on the basis of  
19 how those rate classes cause the costs to be incurred. This process  
20 inherently requires a substantial level of judgment and can be more accurately  
21 described as engineering/accounting art, rather than science. There is no  
22 single, absolutely correct methodology for allocating costs, but there are  
23 certain principles, i.e., cost causation and consistency, that should be followed

1 and that will produce more accurate and reasonable results. The Commission  
2 has repeatedly recognized this fact.

3

4 Q. **Are there reasonably accepted methods for preparing cost allocation**  
5 **studies?**

6 A. Yes, cost allocation studies generally are divided in to three parts:  
7 functionalization, classification and allocation. Functionalization refers to  
8 separating a utility's capital and operating costs by function. For PPL Electric,  
9 this means separating its costs between the transmission and distribution  
10 functions, and then sub-functionalizing those costs between the primary and  
11 secondary voltage levels. Sub-functionalized distribution capital and operating  
12 costs then are "classified" as customer-related, demand-related or energy-  
13 related, or some combination of these factors. Customer-related costs are  
14 those that relate to the number of customers served by the Company, e.g.,  
15 meters. Demand-related costs are those that relate to the peak load/demand  
16 (KW) imposed on the Company's facilities, e.g., primary and secondary  
17 substations. Energy-related costs are those that relate to the total amount of  
18 electricity (KWH) consumed during a given period of time, e.g., purchased  
19 generation supply. Based on this classification, distribution capital and  
20 operating costs are allocated to each rate class based on the number of  
21 customers, maximum demand (kW) or energy (KWH) usage of the particular  
22 rate class.

1           The classification step generally is the most contentious. PPL Electric  
2 adheres to and follows the NARUC Manual Cost Allocation Manual, and the  
3 cost allocation principles set forth therein, to classify its distribution capital and  
4 operating costs. The NARUC specifically states that an electric utility's  
5 distribution-related facilities are, from a design and operational basis, sized to  
6 meet the maximum KW load (demand) requirements of customers. Moreover,  
7 the NARUC Manual also states that all distribution costs should be classified  
8 as either customer or demand-related, or a combination of these factors. To  
9 achieve this classification result, PPL Electric first sub-functionalizes its  
10 distribution capital and operating costs into their primary and secondary  
11 voltage level components. These primary and secondary voltage level capital  
12 and operating costs then are classified based on a "minimum size system"  
13 study, which identifies the portion of those costs required to serve a customer  
14 with minimum or no load, and that portion of the costs is allocated on a  
15 customer basis. The remaining portion of the costs is allocated on a demand  
16 basis, i.e., based on each rate class' maximum NCP demand. This is  
17 explained in detail in Exhibit JMK 3, and is consistent with the NARUC  
18 Manual.

19  
20 **Q. Do all experts accept this classification approach?**

21 **A.** No, they do not. Some experts take issue with the "minimum size system"  
22 study approach. They assert that the demand allocators produced by this type  
23 of study reflect certain equipment that may have some load-carrying capability;

1 they suggest that the zero intercept method may produce a better result.  
2 Others contend that some portion of the fixed components, e.g., poles,  
3 conductors, services, etc., of the distribution system should be classified on an  
4 energy basis. They also assert that the customer component is overstated  
5 and the demand component is understated. I would note that the Company's  
6 "minimum size system" study provided in this proceeding directly addresses  
7 these issues.

8  
9 **Q. Can different classification approaches make a material difference in the**  
10 **outcome of a cost allocation study?**

11 **A.** Yes, they can. To demonstrate this, I have prepared three hypothetical cost  
12 allocation studies using different approaches to classify distribution system  
13 costs. The class cost responsibility results of these studies are set forth in  
14 Exhibit JMK 5, which is attached to this testimony. The first classifies  
15 distribution system costs as 50% customer-related and 50% demand-related.  
16 The results of this study are close to the results achieved using the Company's  
17 long-standing cost allocation methodology and principles. The second  
18 classifies distribution costs as 50% demand-related and 50% energy-related.  
19 The results of this study clearly demonstrate that this allocation approach  
20 shifts a significant amount of capital and operating costs to commercial and  
21 industrial customers. Finally, the third study classifies distribution system  
22 costs as one-third customer-related, one-third demand-related and one-third  
23 energy-related. As expected, the results of this study, which also shift capital

1 and operating costs to commercial and industrial customers, are between the  
2 results of the other approaches.

3  
4 **Q. Is PPL Electric recommending that any of these hypothetical cost**  
5 **allocation approaches be adopted?**

6 A. No, it is not. PPL Electric strongly believes that its cost allocation  
7 methodology, which is based on the specific design and operating  
8 characteristics of the Company's distribution system, provides a more  
9 accurate and reasonable, and consistent, measure of class cost responsibility  
10 than any other approach. The Company has used this methodology in many  
11 previous base rate proceedings and it repeatedly has been relied upon by the  
12 Commission in the past, as the most appropriate guide to use in the design of  
13 the Company's rates. The hypothetical cost allocation approaches are  
14 presented merely to emphasize the point that there can be significant cost  
15 shifting based on the cost allocation methods used. Moreover, I would note  
16 that some reasonable variation from the absolute "cost of service" results are  
17 to be expected when one is seeking to allocate common costs among different  
18 rate classes. Although cost allocation studies may be the "polestar" of rate  
19 design, the Commission should retain some reasonable flexibility and  
20 judgment regarding the application of the results of those studies.

21 Nevertheless, in this proceeding, the Commission should recognize that  
22 PPL Electric's cost allocation studies clearly demonstrate the most accurate  
23 and reasonable, and consistent, measure of class cost responsibility for the

1 provision of distribution service to customers. Because these studies are  
2 based on the specific design and operation of PPL Electric's distribution  
3 system, they provide the best representation of how, and for whom, the  
4 Company incurs capital and operating costs to provide distribution service to  
5 its customers.

6  
7 **Q. Please explain Section III of Exhibit JMK 3.**

8 **A.** Section III of Exhibit JMK 3 provides the derivation of the proposed metering  
9 and billing credits set forth in the Metering and Billing Credit Rider of PPL  
10 Electric's Tariff-Electric Pa. P.U.C. No. 201 ("Tariff No. 201"). These credits  
11 are applied to a customer's monthly distribution charges when an Electric  
12 Generation Supplier ("EGS"), licensed by the Commission, provides metering,  
13 meter reading and/or billing and collection service to a customer in lieu of PPL  
14 Electric.

15 The credits were derived by determining the revenue requirement, by  
16 rate schedule, for each individual service (metering, meter reading and/or  
17 billing and collection) that could be provided to a PPL Electric customer by an  
18 EGS. The revenue requirement calculations are based on the applicable pro  
19 forma rate base and operating expenses for the 12 months ending  
20 December 31, 2010, as set forth in Exhibit JMK 2.

21 The proposed credits, which are shown on page 1 of Section III of  
22 Exhibit JMK 3, were aggregated into the following customer groups:

1 residential; all other secondary voltage level; primary voltage level; and  
2 transmission voltage level.

3  
4 Purchase of Receivables

5 Q. **Does PPL Electric have a Commission-approved POR Program in place**  
6 **for calendar year 2010?**

7 A. Yes. PPL Electric filed its current POR Program, which is a completely  
8 voluntary program, in response to the Commission's Retail Markets Orders at  
9 Docket No. M-2009-2104271. PPL Electric initially had agreed to file a POR  
10 Program to become effective on January 1, 2011, as part of the settlement of  
11 its recent default service plan proceeding at Docket No. P-2008-2060309.  
12 However, in its Retail Markets Orders, the Commission instructed the  
13 Company to implement a POR Program to commence on January 1, 2010.

14 As a result, and because of PPL Electric's support of the Commission's  
15 efforts to promote retail competition in the Company's service territory, it filed a  
16 proposed POR Program pursuant to the Retail Markets Orders and in advance  
17 of the date that the Company agreed to in its default service plan proceeding.  
18 In that filing, the Company also proposed to unbundle generation-related  
19 uncollectible accounts expense from its distribution base rates and to collect  
20 them through a MFC. The MFC would be added to PPL Electric's Price to  
21 Compare ("PTC"), so that electric generation suppliers ("EGSs") would be able  
22 to reflect uncollectible costs in their 2010 competitive supply offers.

1           Because of the time constraints associated with making that filing, the  
2 Company proposed a reasonable, middle-of-the-road approach which would  
3 promote competition by providing EGSs that choose to participate in the  
4 proposed POR Program with certainty as to uncollectible costs. In addition,  
5 even if a particular EGS chose not to participate in the POR Program, it would  
6 be able to reflect generation-related uncollectible costs in its competitive offer,  
7 because PPL Electric's default service generation-related uncollectible  
8 accounts expense would be included in its PTC.

9           I would note that the technical operation of the Company's current POR  
10 Program is addressed in the direct testimony of Mr. Krall (Statement No. 5).

11

12 Q.   **You indicated that the Company had agreed to file a POR Program as**  
13 **part of the settlement of its recent default service plan proceeding,**  
14 **please explain.**

15 A.   Under the terms of that settlement, the Company agreed to file a POR  
16 Program as part of its next distribution rate case. In the absence of a  
17 distribution rate case filing with an effective date of January 1, 2011, PPL  
18 Electric agreed to file, by July 1, 2010, a stand-alone POR Program to be  
19 effective on January 1, 2011. The default service plan settlement also  
20 provided for PPL Electric to conduct at least three stakeholder meetings to  
21 discuss the provisions of a POR Program. By limiting the term of its current  
22 POR Program to calendar year 2010, PPL Electric was able to comply with the  
23 conditions that it agreed to under the default service plan settlement.

1

2 Q. **Does PPL Electric purchase EGS accounts receivables at a discount?**

3 A. Yes. The Company purchases EGS accounts receivables at a discount which  
4 consists of the following two components: (1) the uncollectible accounts  
5 expense percentage factor (which equals the MFC), and (2) a POR  
6 development, implementation and administration percentage factor. I would  
7 note that the discount rates for the residential and small C&I customer classes  
8 are different because the uncollectible accounts expense percentages for  
9 these two customer classes are different.

10

11 Q. **Is PPL Electric proposing to update these discount rates in this  
12 proceeding?**

13 A. Yes, it is.

14

15 Q. **What is the proposed discount rate for the residential customer class?**

16 A. The proposed discount rate for the residential customer class is 1.854%. This  
17 discount reflects an uncollectible accounts expense percentage factor of  
18 1.804% and a POR administrative percentage factor of 0.05%.

19

20 Q. **What is the proposed discount rate for the small C&I customer class?**

21 A. The proposed discount rate for the small C&I customer class is 0.057%. This  
22 discount reflects an uncollectible accounts expense percentage factor of  
23 0.007% and a POR administrative percentage factor of 0.05%.

1 Q. **How were the uncollectible accounts expense percentages or MFC**  
2 **factors developed?**

3 A. The uncollectible accounts expense or MFC factors were developed from  
4 future test year data for the 12 months ending December 31, 2010. The  
5 Company's budgeted provision for uncollectible accounts expense of \$38.2  
6 million primarily is based on an average of its actual bad debt write-offs for the  
7 most recent five calendar years (2004-2008). The assignment of this  
8 uncollectible accounts expense to the residential, small C&I and large C&I  
9 customer classes, as well as the resulting uncollectible accounts expense  
10 percentages, are set forth on Exhibit JMK 4, which is attached to this  
11 testimony.

12

13 Q. **How is the POR administrative factor percentage developed?**

14 A. Under its current POR Program, the Company recovers its POR administrative  
15 costs as a percentage of EGSs' supply charges to shopping customers.  
16 Therefore, in order to develop a POR administrative percentage factor, the  
17 Company must estimate: (1) its POR administrative costs, (2) shopping  
18 levels, (3) POR Program participation levels, and (4) average competitive  
19 supply rates. However, because the Company has very limited experience  
20 regarding the operation of its current POR Program, which began on January  
21 1, 2010, PPL Electric is proposing to continue using its current POR  
22 administrative percentage factor of 0.05% to recover its POR administrative

1 costs, until such time as it obtains more actual experience with the  
2 implementation of its POR Program.

3  
4 **Q. Is the current POR Program voluntary for EGSs?**

5 A. Yes. The current POR Program is completely voluntary. EGSs can choose to  
6 participate in the POR Program or choose not to participate. As explained in  
7 more detail below, in conjunction with the proposed POR Program, the  
8 Company unbundled the generation supply-related uncollectible accounts  
9 expense from its distribution base rates and now collects them through the  
10 MFC. Therefore, if an EGS chooses not to participate in the POR Program,  
11 the EGS is still able to reflect uncollectible costs in its competitive supply offers  
12 to customers.

13  
14 **Q. Does PPL Electric require EDCs that participate in the POR Program to**  
15 **use EDC consolidated billing?**

16 A. Yes. PPL Electric believes that it should not be required, under any  
17 circumstances, to pay for accounts receivables associated with amounts that  
18 have been billed by another entity. If this were permitted, PPL Electric would  
19 have no control over revenues received and could be in the position of  
20 terminating service for purchased receivables that, in fact, may have been  
21 paid. The Company does not believe that this result is appropriate.

22  
23

1 Q. **Please explain the application of PPL Electric's MFC.**

2 A. As part of its current POR Program, PPL Electric unbundled the uncollectible  
3 accounts expense associated with generation supply from its distribution rates.

4 As a result, PPL Electric recovers only its uncollectible accounts expense  
5 associated with non-generation supply-related delivery service through its  
6 distribution rates. Uncollectible accounts expense associated with generation  
7 supply for default service customers is separated from the Company's  
8 distribution rates and recovered through the MFC, and included in its PTC. I  
9 would note that, in this proceeding, PPL Electric is proposing to modify the  
10 language of its TSC recovery mechanism to permit recovery of the  
11 uncollectible accounts expense associated with transmission service through  
12 application of the MFC.

13 For each of the two eligible customer classes, the MFC is equal to the  
14 uncollectible accounts expense percentage included in the discount  
15 percentage under the Company's current POR Program.

16

17 Q. **Does this conclude your direct testimony?**

18 A. Yes, it does

**Proceedings in Which Mr. Kleha  
Provided Expert Testimony**

As an analyst in the Pennsylvania Public Utility Commission's ("PUC") former Bureau of Rates and Research, Mr. Kleha offered testimony in the following electric utility rate proceedings:

<b><u>Company</u></b>	<b><u>Docket No.</u></b>
Duquesne Light Company	R-79010740
UGI Corp. - Luzerne Division	R-79050863
Philadelphia Electric Company	R-79060865
West Penn Power Company	R-80021082
Pennsylvania Power & Light Co.	R-80031114
Metropolitan Edison Company	R-80051196
Pennsylvania Electric Company	R-80051197

As an employee of PPL Electric and PPL Services, Mr. Kleha has offered expert testimony in the following electric and gas utility proceedings before the PUC and the Federal Energy Regulatory Commission ("FERC").

<b><u>PA PUC</u></b>	<b><u>FERC</u></b>
Docket No. I-900005	Docket No. ER88-545-000
Docket No. P-910521	Docket No. ER91-322-000
Docket No. M-00930406	Docket No. ER95-1267-000
Docket No. C-00935175	Docket No. ER96-930-000
Docket No. C-00935403	Docket No. ER96-931-000
Docket No. R-00943271	Docket No. ER96-932-000
Docket No. C-00957559	Docket No. ER96-933-000
Docket No. P-00961023	Docket No. ER96-1428-000
Docket No. C-00967591	Docket No. SC97-1-000
Docket No. C-00967955	Docket No. OA96-142-000
Docket No. C-00968035	Docket No. ER97-4829-000
Docket No. P-00961114	Docket No. ER97-3189-007
Docket No. R-00973954	Docket No. EL98-25-000
Docket No. P-00001789	Docket No. ER02-597-000
Docket No. M-FACE9908	Docket No. ER03-421-002
Docket No. R-00005277	Docket No. ER04-056-000
Docket No. M-FACE0008	Docket No. ER08-1457-000
Docket No. M-FACE0111	Docket No. ER10-152-000
Docket No. R-00016850	
Docket No. M-FACE0212	
Docket No. M-FACE0311	

**PA PUC**

**FERC**

Docket No. R-00049255\*  
Docket No. M-FACE0411  
Docket No. M-FACE0510  
Docket No. M-FACE0511  
Docket No. R-00061398  
Docket No. P-00062227  
Docket No. M-FACE0611  
Docket No. M-FACE0612  
Docket No. M-2008-2012856  
Docket No. R-00061906  
Docket No. R-2008-2013780  
Docket No. R-00072155  
Docket No. A-2008-2034047 etc.  
Docket No. P-2008-2060309  
Docket No. A-2008-2022941  
Docket No. M-2008-2078645  
Docket No. M-2008-2078647  
Docket No. M-2008-2078709  
Docket No. M-2008-2078713  
Docket No. A-2009-2082652  
Docket No. M-2009-2093216  
Docket No. P-2009-2129502  
Docket No. R-2009-2122718  
Docket No. M-2009-2145186  
Docket No. M-2009-2145189  
Docket No. M-2009-2145838

\* Includes Remand proceeding.