

COMMONWEALTH OF PENNSYLVANIA



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November 4, 2010

**HAND DELIVERED**

Rosemary Chiavetta, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120

**Re: Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation  
Docket No. R-2010-2161694**

Dear Secretary Chiavetta:

Enclosed for filing are the original and nine (9) copies of the Exceptions, on behalf of the Office of Small Business Advocate, in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink that reads "Steven C. Gray".

Steven C. Gray  
Assistant Small Business Advocate  
Attorney ID No. 77538

Enclosures

cc: Cheryl Walker Davis  
Office of Special Assistants

Robert D. Knecht

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Pennsylvania Public Utility Commission :  
v. : DOCKET NO. R-2010-2161694  
PPL Electric Utilities Corporation :**

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**EXCEPTIONS  
ON BEHALF OF THE  
OFFICE OF SMALL BUSINESS ADVOCATE**

**Steven C. Gray  
Assistant Small Business Advocate  
Attorney ID # 77538**

**For: William R. Lloyd, Jr.  
Small Business Advocate  
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**Office of Small Business Advocate  
300 North Second Street - Suite 1102  
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**Dated: November 4, 2010**

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## **I. INTRODUCTION**

On March 31, 2010, PPL Electric Utilities Corporation (“PPL” or the “Company”) filed with the Pennsylvania Public Utility Commission (“Commission”) a request for additional annual distribution revenues of \$114.675 million.

On May 20, 2010, the Commission suspended the proposed effective date of PPL’s filing and instituted an investigation into the justness and reasonableness of the issues raised in the filing.

On April 29, 2010, the Office of Small Business Advocate (“OSBA”) filed a complaint against the PPL filing.

On May 26, 2010, a prehearing conference was held before Administrative Law Judge (“ALJ”) Susan D. Colwell.

On May 27, 2010, ALJ Colwell issued her Scheduling Order.

On June 29, 2010, the OSBA submitted the direct testimony of Robert D. Knecht. On July 27, 2010, the OSBA submitted the rebuttal testimony of Mr. Knecht. On August 5, 2010, the OSBA submitted the surrebuttal testimony of Mr. Knecht.

On August 26, 2010, the parties filed a partial settlement, which established \$77.5 million as the revenue requirement. The OSBA did not sign the partial settlement but also did not oppose it. Under the partial settlement, numerous issues, *e.g.*, cost of service and revenue allocation, were reserved for litigation.

Evidentiary hearings were held in Harrisburg on August 11, 2010.

On September 2, 2010, the OSBA submitted a main brief.

On September 13, 2010, the OSBA submitted a reply brief.

On October 15, 2010, the Commission issued ALJ Colwell's Recommended Decision ("RD").

The OSBA submits the following exceptions in response to the RD.

## II. STATEMENT OF THE CASE

### A. PPL's 2004 Base Rate Case

On March 29, 2004, PPL filed with the Commission a proposed \$164.4 million increase in distribution rates. As part of the same case, PPL also sought a \$57.2 million increase in transmission rates.

As part of PPL's March 2004 filing, the Company performed a cost of service study ("COSS") to determine what share of PPL's distribution costs should properly be borne by each of the Company's various customer classes.

Although PPL performed a COSS for its 2004 distribution base rates case, the Company did not rely on the results of that COSS for its proposed allocation of the distribution rate increase. Instead, the Company imposed a "10% on a total-bill basis" limit on the combination of the distribution and transmission rate increase that could be imposed on any class.

The Commission upheld PPL's interclass distribution revenue allocation by evaluating the rate increase on a total-bill basis. The Commission concluded that it is not necessary to adhere strictly to a COSS and that, on the facts of that case, sufficient progress was being made toward cost-based distribution rates. *Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255 (Order entered December 22, 2004), at 81-82.

In an appeal to the Commonwealth Court, the OSBA pointed to the discriminatory effect of the distribution revenue allocation on the commercial GS-1 customer class. Specifically, the GS-1 class received a higher-than-system average distribution rate increase despite having an above-system average rate of return under the rates in effect at the time of the March 2004 filing.

In reversing the Commission's distribution revenue allocation decision, the Commonwealth Court held "that rates and rate structures [must] be set for each service primarily

on a cost-of-service study.” *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006), *appeals denied*, 916 A.2d 1104 (Pa. 2007). Although the Court indicated that the Commission may consider other factors, such as gradualism, the Court characterized cost of service as the “polestar” of ratemaking concerns. Specifically, the Commonwealth Court stated as follows:

However, while permitted, gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time.

\* \* \*

[I]n effect, the Commission has determined that the principle of gradualism trumps all other ratemaking concerns - especially the polestar - cost of providing service.

*Lloyd*, 916 A.2d at 1020.

Webster’s Third New International Dictionary defines “polestar” as “a directing or controlling principle.”

The Commonwealth Court also pointed out that the Commission had provided “no explanation how discrimination in distribution and transmission rate structures [is] eventually going to be gradually alleviated.” *Lloyd*, 904 A.2d at 1020.

Finally, the Commonwealth Court “remanded to the Commission to set non-discriminatory reasonable rates and rate structure for each service.” *Lloyd*, 904 A.2d at 1029.

On remand, PPL’s 2004 base rate case ultimately settled, with the GS-1 customer class receiving a less than system average rate increase. The settlement document in the 2004 base rate remand proceeding stated as follows:

PPL Electric also proposed [in the remand proceeding] to move its distribution rates for all major rate classes to at or near full cost of service over the course of three rate cases, including the 2004 rate case.

*Joint Petition for Settlement of Remand Proceeding*, Docket No. R-00049255, at Paragraph 20.

See also, PPL Statement No. Remand-1, at 11. The Commission approved the settlement by Order entered July 25, 2007.

**B. PPL's 2007 Base Rate Case**

On March 29, 2007, PPL filed with the Commission a proposed \$83.6 million increase in distribution rates.

PPL's 2007 base rate case also settled. In that settlement, the GS-1 customer class received a rate *decrease*. PPL's other rate classes that include small business customers, *i.e.*, the GS-3 and GH customer classes, were assigned rate increases below system average.

*Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00072155 (Order entered December 6, 2007), at 29-31.

**C. PPL's 2010 Base Rate Case**

On March 31, 2010, PPL filed with the Commission a proposed \$114.675 million increase in distribution rates.

This proceeding is the third of the three cases by which PPL committed to move its customer classes to at or near cost of service. PPL Main Brief, at 34. However, the Company did not keep its commitment to move its customer classes to at or near cost of service. PPL explained that increases in excess of the \$114.675 million total would have had to be assigned to

the residential class, and other classes would have had to receive significant rate decreases, in order for the Company to reach its goal. PPL Main Brief, at 34-35.

Instead of keeping its promise at the originally filed full revenue requirement, PPL proposed to allocate no distribution rate increase to the GS-1, GS-3, GH, or LPEP customer classes. Based on PPL's COSS, those classes should have received rate decreases. PPL Exhibit JMK-2. PPL further proposed to limit the increase to the residential rate classes to \$114.638 million.

The parties reached an agreement to allow PPL to increase the Company's distribution rates by \$77.5 million per year, instead of by the \$114.675 million originally requested.

At the reduced revenue requirement, the Company reasoned that "because the residential rate class would have received the entire rate increase under PPL Electric's filing, the residential rate classes should benefit from the entire scaleback of the original proposed increase [from \$114.675 million to \$77.5 million] in annual distribution operating revenues." PPL Main Brief, at 42.<sup>1</sup> Thus, the GS-1, GS-3, GH, or LPEP customer classes would continue to receive no increase at the settled revenue requirement rather than to be assigned rate increases.

The OSBA opposed PPL's allocation of the reduced revenue requirement. In that regard, OSBA witness Robert D. Knecht stated:

Thus, simply because the Company's proposal for a zero rate increase . . . may have been reasonable at the full revenue requirement, it cannot be concluded that a zero increase is reasonable under a reduced revenue requirement.

OSBA Statement No. 3, at 8.

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<sup>1</sup> This assertion by PPL is technically incorrect. PPL originally allocated rate increases to the RS, RTS, ISP, and LP-5 rate classes. PPL allocated rate decreases to the LP-4 and LP-6 rate classes. PPL Exhibit JMK-2. Most of these rate changes were related to harmonizing the rates charged within the ISP and LP-4 rate schedules, and the rates charged in the LP-5 and LP-6 rate schedules. OSBA Statement No. 1, at 23-24. No party took exception to this rate harmonization proposal.

In order to allocate the reduced revenue requirement in a manner that complies with *Lloyd* and is consistent with PPL's promise, the OSBA proposed First Dollar Relief ("FDR") for GS-1, GS-3, and LPEP, which are overpaying customer classes under both the COSS methodologies PPL submitted in this proceeding. Mr. Knecht explained the problem of assigning no rate decrease to overpaying classes, as follows:

However, it is critical to recognize that, as the Company's revenue requirement is reduced, the GS-1 class revenues will move even farther away from allocated costs unless they are also reduced. For example, under the Exhibit JMK-2B ("PPL Prior Method") COSS, the GS-1 class rate of return is 12.4 percent, or 3.3 percentage points above the system average return of 9.1 percent. However, if the approved revenue requirement is based on an 8.1 percent system average return on rate base, and no decrease is assigned to the GS-1 class, the excess return (i.e., the amount above the system average) from the GS-1 class will increase from 3.3 to 4.3 percentage points. That will be a substantial increase in the magnitude of the cross-subsidy provided by GS-1.

Thus, simply because the Company's proposal for a zero rate increase for the GS-1 class may have been reasonable at the full revenue requirement, it cannot be concluded that a zero increase is reasonable under a reduced revenue requirement.

OSBA Statement No. 3, at 7-8 (footnote omitted).

Mr. Knecht further contrasted his FDR proposal with the Company's scaleback, as follows:

My scaleback proposal addresses this specific issue. By scaling back revenues from all rate classes (including [providing] rate reductions for the overpaying classes), my proposal will retain the

progress toward cost-based rates that is built into my revenue allocation proposal at the full revenue requirement.

OSBA Statement No. 3, at 8.

### III. EXCEPTIONS

**Exception No. 1: The ALJ erred when she ruled that using First Dollar Relief to reduce the rates of the overpaying commercial customer classes is inconsistent with ratemaking principles. (RD, at 55)**

The ALJ acknowledged that this is the third of the three cases envisioned by PPL to achieve compliance with *Lloyd*. Specifically, the ALJ stated, as follows:

The Company declared its intent to achieve rate parity (or near parity) over the course of three rate cases: the remand of the 2004 case, the 2007 case which resulted in a complete settlement, and this case.

RD, at 1.

Unfortunately, the ALJ did not acknowledge the mandate of *Lloyd* that “gradualism cannot be allowed to trump all other valid ratemaking concerns.” *See* RD, at 47-48. *See also*, *Lloyd*, 916 A.2d at 1020.

As set forth in the Statement of the Case above, the OSBA proposed the use of FDR in order to move PPL’s rate classes toward cost of service in compliance with *Lloyd*’s mandate that such movement not take an “extended period of time.” Mr. Knecht observed as follows:

Even if GS-1 is assigned a zero increase in future PPL Electric base rates cases, it will likely take multiple cases before the rate of return for the GS-1 class will drop to the system average.

OSBA Statement No. 3, at 7 (footnote omitted).

The ALJ responded to the OSBA proposal as follows:

[T]his FDR approach is unprecedented (the cases cited by OSBA in support of its approach, see OSBA Main Brief at 19 were reduced increases, not decreases of existing rates). OSBA proposes FDR to produce a rate decrease for a rate class, which is *not supported by any existing case law*.

RD, at 54.

The ALJ concluded:

Therefore, using it [the OSBA's FDR methodology] to reduce existing rates for classes which were not slated to incur an increase, thus increasing the rates of those which were slated for increases, is inconsistent with traditional ratemaking principles.

RD, at 55 (emphasis omitted).

In reaching that conclusion, the ALJ overlooked the point that *Lloyd* does not sanction rate classes' overpaying their cost of service for an "extended period of time." In view of PPL's previous commitment, assigning a zero increase to the overpaying customer classes is not sufficient progress to satisfy *Lloyd*.

Although the ALJ complained that there is no case law to support the use of FDR for the purpose of rate reductions, she did not cite to any case law which forbids that practice. In that regard, the OSBA observed in its main brief that the FDR proposal complies with the FDR approved by the Commission in *Pennsylvania Public Utility Commission v. PPL Gas Utilities Corporation*, Docket No. R-00061398 (Order entered February 9, 2007). In response, the ALJ attempted to distinguish *PPL Gas Utilities*. Specifically, the ALJ asserted that "the cases cited by OSBA in support of its approach, see OSBA Main Brief at 19 were reduced increases, not decreases of existing rates." RD, at 55. The ALJ apparently accepts *PPL Gas Utilities* as precedent for FDR to scale back proposed increases but to reject *PPL Gas Utilities* as authority for using FDR to award rate decreases.

Moreover, the ALJ's claim that such rate reductions violate traditional ratemaking principles was not supported by any citation to case law, treatise, or regulation. However, regardless of what constitutes "traditional ratemaking principles," the *Lloyd* decision was filed in August of 2006. Three full base rate cases later, the GS-1 and GS-3 classes will still be overpaying their cost of service. That result amounts to making selected classes overpay for an

“extended period of time,” especially since they were overpaying at least as long ago as PPL’s 2004 base rate case.<sup>2</sup>

Even if the Commission is unwilling to order rate cuts in this proceeding, the Commission should not adopt the ALJ’s *per se* rule against using FDR as the basis for rate reductions. The ALJ has provided no explicit support for her *per se* rule. More importantly, rate reductions could easily become a critical and useful tool for the Commission in order to meet the requirements of *Lloyd* in cases involving other utilities. For example, there may be future rate cases where assigning a rate class a zero increase is simply insufficient to make meaningful progress toward cost of service. The ALJ’s *per se* rule would strip the Commission of FDR as a tool to move rates more into line with costs.

Moreover, because it appears to apply only to FDR and not to full requirements proposals, the ALJ’s theory would make it acceptable to adopt an alternative full requirement revenue allocation that would give residential customers a higher rate increase than proposed by the utility in order to give other rate classes a decrease. However, under the ALJ’s theory, it would be unacceptable to employ the more moderate FDR approach of capping the residential rate increase at the amount requested by the Company at the full revenue requirement and using at least some of the scaleback to reduce rates for those other classes. The ALJ offers no rationale as to why rate reductions that result from FDR should be banned, while rate reductions which result from a full requirements revenue allocation are acceptable.

The OSBA respectfully requests that the Commission reject the ALJ’s *per se* rule even if it does not order any rate reductions in this case.

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<sup>2</sup> In fact, the overpayment by GS-1 and GS-3 customers has existed for decades. *See, e.g.*, Recommended Decision of Administrative Law Judge Robert A. Christianson, Docket No. R-00943271 (Issued July 28, 1995) at 219. *See also, Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company*, Docket No. R-00943271 (Order entered September 27, 1995) at 211-212.

**Exception No. 2: The ALJ erred when she did not provide rate relief for the GS-1, GS-3, and LPEP customer classes. (RD, at 58)**

In her RD, the ALJ recommended that “the [settled] revenue requirement amount of \$77.5 million should be allocated to the rate classes proportional to the Company’s originally requested amount.” RD, at 58. As originally filed by the Company, the GS-1, GS-3, and LPEP rate classes were assigned no increase. PPL Exhibit JMK-2, at 94-95. The proportional reduction advocated by PPL and recommended by the ALJ would assign no increase to those customer classes.

However, due to changes in the rate design for the GS-3 customers, many of the smaller GS-3 customers actually will see a significant increase in their distribution rates. Mr. Knecht explained the changes to the GS-3 rate design as follows:

The current GS-3 distribution tariff consists only of a demand charge, with a minimum billing demand of 25 kW. PPL Electric proposes to modify the GS-3 tariff to include a \$50 per month customer charge, and to eliminate the minimum billing demand. In order to keep the overall class rate increase at zero, PPL Electric proposes to reduce the demand charge.

\* \* \*

For a 25 kW GS-3 customer, the impact of the PPL Electric proposal would be a monthly bill increase from \$116.93 to \$156.65, an increase of some 34 percent. This increase is about twice the system average distribution increase, and may result in customer dissatisfaction within a rate class that faces a zero overall increase.

Therefore, to mitigate the effect on smaller GS-3 customers, I recommend that the GS-3 customer charge in this proceeding be limited to \$30 per kW. Based on the figures in Attachment IV-C (page 9 of 27), I calculate that setting the GS-3 demand charge at \$4.5106 per kW of billing demand would produce the same revenues as PPL Electric’s proposal. This change would reduce the bill impact on a 25 kW GS-3 customer from 34 percent to 22 percent.

OSBA Statement No. 2, at 18-20. The OSBA's proposal to mitigate the rate increase for smaller GS-3 customers was acceptable to PPL. PPL Main Brief, at 22-23. Furthermore, the ALJ recommended approval of the OSBA proposal. RD, at 58-59. Nevertheless, regardless of the zero rate increase allocated to the GS-3 customer class by the Company, smaller GS-3 customers will see a significant increase in their distribution rates as a result of this case.

As set forth in the Statement of the Case above, the OSBA opposes the proportional scaleback recommended by the ALJ because it reduces the progress toward cost of service originally proposed by PPL for the GS-1, GS-3, and LPEP customer classes. Mr. Knecht provided an example of the problem, as follows:

However, it is critical to recognize that, as the Company's revenue requirement is reduced, the GS-1 class revenues will move even farther away from allocated costs unless they are also reduced. For example, under the Exhibit JMK-2B ('PPL Prior Method') COSS, the GS-1 class rate of return is 12.4 percent, or 3.3 percentage points above the system average return of 9.1 percent. However, if the approved revenue requirement is based on an 8.1 percent system average return on rate base, and no decrease is assigned to the GS-1 class, the excess return (i.e., the amount above the system average) from the GS-1 class will increase from 3.3 to 4.3 percentage points. That will be a substantial increase in the magnitude of the cross-subsidy provided by GS-1.

OSBA Statement No. 3, at 7-8 (footnote omitted).

Essentially, when a customer class is overpaying its cost of service, giving that customer class a zero rate increase will move that customer class to cost of service only as fast as the system, as a whole, is "catching up" with that overpaying class. Using Mr. Knecht's example, if GS-1 is already paying a rate of return of 12.4 percent, and PPL holds that class where it is (assigning it a zero rate increase), the larger the overall distribution revenue increase (e.g., based on a 9.1 percent proposed rate of return), the closer GS-1 moves toward cost of service. If the Company accepts a smaller revenue increase (i.e., where the Company has settled for \$77.5

million instead of the requested \$114.675 million, resulting in a rate of return lower than 9.1 percent), the GS-1 class will be making much less progress toward cost of service. Simply put, with the lower revenue increase, the system, as a whole, is not “catching up” with the overpaying GS-1 rate class as fast as it was in the original filing. The ALJ was fully aware of this problem that results from the reduced revenue requirement, and acknowledged this issue in her RD. RD, at 53.

In order to address this problem, the OSBA recommended that FDR be provided to the GS-1, GS-3, and LPEP rate classes. Mr. Knecht explained the FDR proposal, as follows:

If the Commission awards less than the full revenue requirement requested by the Company, I propose that a FDR mechanism be employed to increase progress toward cost-based rates. The FDR has a number of advantages over the traditional approach of adjusting the full requirement revenue allocation. First, FDR cannot cause rates for any customer class to be higher than those proposed by the utility. Thus, no customer will face an increase higher than what he expected based on the rate increase notice from the utility. Second, FDR can be targeted to maintain or even improve the progress toward cost-based rates that was built into the original revenue allocation proposal.

OSBA Statement No. 1, at 28-29 (footnote omitted).

The OSBA’s FDR proposal for the GS-1, GS-3, and LPEP classes is consistent with the FDR approved by the Commission in *Pennsylvania Public Utility Commission v. PPL Gas Utilities Corporation*, Docket No. R-00061398 (Order entered February 9, 2007). In *PPL Gas Utilities*, FDR was provided for the only class with an above-system average rate of return at proposed rates.

The following table sets forth the class rates of return at proposed rates using the Company’s JMK-2A cost of service study, which the ALJ adopted:

PPL Cost of Service Study JMK-2A	
Class Rates of Return at Proposed Rates (Full Revenue Requirement)	
RS	7.13%
RTS	-0.24%
GS-1	10.3%
GS-3	22.68%
LP-4	13.17%
ISP	12.32%
LP-5	-23.34%
LP-6	-75.42%
LPEP	14.83%
GH	13.69%
SL/AL	9.14%
<b>Total</b>	<b>9.07%</b>

PPL Exhibit JMK-2A, at 94-95.

As set forth above, this Table demonstrates that the GS-1, GS-3, and LPEP customer classes have rates of return above the system average at the Company's proposed rates.<sup>3</sup>

Therefore, FDR is appropriate for those rate classes in this proceeding.

Mr. Knecht proposed specific FDR as follows:

To improve progress toward cost-based rates, I recommend that the first \$18.1 million in any reduction to the Company's proposed rate increase be assigned to these three classes (\$6 million to GS-1, \$12 million to GS-3 and \$135,000 to LPEP). I base these dollar values on the objective of providing rate relief to these classes, but

<sup>3</sup> The OSBA based its original revenue allocation on an average of the Company's new and previous cost of service studies (JMK-2A and JMK-2B), and focused its efforts on those classes that were overpaying based upon that average. See OSBA Statement No. 1, at 28-31.

retaining the requirement that the class rate of return after FDR remains at or above the system average under both COSS methodologies.

OSBA Statement No. 1, at 29.

Mr. Knecht's "first \$18.1 million" is readily available as the \$77.5 million settlement revenue increase is more than \$18.1 million below the Company's filed revenue request of \$114.675 million. In other words, the Commission can award \$18.1 million in rate reductions to GS-1, GS-3, and LPEP without assigning a larger rate increase to the residential classes than originally proposed by PPL.

Furthermore, an additional \$19.1 million of the proposed revenue increase (\$114.675 million minus \$77.5 million minus \$18.1 million) is available for allocation by the OSBA's FDR proposal. Mr. Knecht explained the OSBA's proposed allocation of that \$19.1 million, as follows:

I therefore recommend that any further reduction be applied to all rate classes, in proportion to class distribution revenues after the increase and after the FDR. Thus, for example, an additional reduction of \$20 million after FDR would represent about 2.4 percent of distribution revenues. Every class' distribution revenues after FDR would therefore be reduced by 2.4 percent.

OSBA Statement No. 1, at 31.

A table showing the OSBA's proposed revenue allocation at the \$77.5 million settled revenue requirement is set forth below. The revenue allocation is based on Mr. Knecht's FDR methodology, but uses the Company's original revenue allocation as the starting point.

<b>PPL Revenue Allocation with OSBA FDR</b> <b>\$77.5 Million Settled Revenue Requirement (in thousands)</b>	
RS	\$99,400
RTS	2,086
GS-1	(7,695)
GS-3	(14,634)
LP-4	(1,016)
ISP	210
LP-5	18
LP-6	(12)
LPEP	(143)
GH	(159)
SL/AL	(557)
<b>Total</b>	<b>\$77,500</b>

Under this proposal, the residential classes (RS and RTS) would receive a rate increase of only \$101.486 million, rather than the \$114.638 million proposed by PPL at the full revenue requirement.

Rate cuts are appropriate in this proceeding for the GS-1, GS-3, and LPEP classes. As the ALJ acknowledged, this is the third of three cases by which the Company committed to moving its customer rate classes to at or near their cost of service. As Mr. Knecht explained, the OSBA FDR would not move the Company's rate classes all the way to their cost of service, but it would "improve progress towards cost-based rates." OSBA Statement No. 1, at 29. In other words, GS-1, GS-3, and LPEP would continue to have rates of return above the system average even under the OSBA's proposal, but the difference between their rates of return and the system average would decline. Moreover, because the OSBA's proposal was designed such that rates for GS-1 and GS-3 customers would not fall below allocated cost under *either* COSS

methodology advanced by PPL in this proceeding, it is perfectly applicable to the COSS presented in Exhibit JMK-2A upon which the ALJ relies for her recommendations.

In view of the foregoing, the OSBA respectfully requests that the Commission reject the ALJ's revenue allocation, and adopt the OSBA's FDR proposal, which will provide rate reductions for the GS-1, GS-3, and LPEP customer classes.

**Exception No. 3: The ALJ erred when she did not provide rate relief for the GS-1 customer class. (RD, at 58)**

As set forth in the Statement of the Case above, the ALJ's recommendation to scale back the reduced revenue requirement proportionately will result in the GS-1 customer class receiving no rate increase in this proceeding. However, as acknowledged by the ALJ, it will also dilute the progress toward cost of service that the GS-1 customer class was making at the Company's originally filed revenue request. RD, at 53.

The FDR mechanism proposed by Mr. Knecht is consistent with moving rates into line with allocated costs under the Company's JMK-2A cost of service study, with Commission precedent in *PPL Gas Utilities*, with *Lloyd*, and with the commitment made by the Company in the remand of PPL's 2004 base rates proceeding.

However, the OSBA also recognizes that there is a difference of opinion about the proper COSS on which to base the revenue allocation in this case. For example, a difference of opinion exists as to whether the GS-3 customer class would need a rate decrease or a rate increase in order to move to full cost of service.

Based on its view of cost of service, the OCA would allocate a \$10.925 million increase to GS-3 at the \$77.5 million settlement revenue requirement. RD, at 57. The OCA's proposed allocation to the GS-3 customer class is based simply upon the differences between the OCA cost of service methodology and that used in PPL's JMK-2A. *See* RD, at 56-57.

In contrast, there is no disagreement among the parties that the GS-1 customer class is overpaying its cost of service and should receive no rate increase. Specifically, the parties' disagreement over the appropriate COSS methodology does not affect the conclusion that GS-1

customers are providing a rate of return at present rates that materially exceeds PPL's proposed rate of return at the full revenue requirement.<sup>4</sup>

Similarly, the LPEP class provides a rate of return well in excess of the proposed system average under all COSSs. *See OCA Main Brief, at 7.*

Consequently, if the Commission rejects the FDR proposal set forth in the OSBA Main Brief, at 21, and repeated in Exception No. 2, the OSBA recommends the following alternative FDR proposal that would provide relief to GS-1 and LPEP because they are the two classes that are overpaying under every COSS in this proceeding.

The OSBA alternative proposal starts with the full requirement revenue allocation proposed by PPL in its original filing. From that revenue allocation, targeted FDR would be provided to the GS-1 and LPEP classes, as proposed in Mr. Knecht's direct testimony. *See OSBA Statement No. 1, at 29.* Specifically, the GS-1 customer class should be provided with a \$6.0 million rate cut and the LPEP class should be provided with a \$135,000 rate cut. *See OSBA Statement No. 1, at 29 and OSBA Reply Brief, at 15-18.*

Following this limited FDR, the remaining amount by which the settlement reduced the full revenue requirement should be allocated by a traditional proportional scaleback. As a result, only those rate classes assigned increases at the full revenue requirement would share in the remaining \$31.040 million reduction in the full revenue requirement.

The following table sets forth the OSBA's alternative revenue allocation proposal using the Company's original allocation as the starting point. The table compares the OSBA's alternative to the OSBA's preferred FDR scaleback set forth in Exception No. 2, above.

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<sup>4</sup> The class rates of return for GS-1 (at present rates) under the four COSS methodologies in this proceeding (*i.e.*, PPL JMK-2A, PPL JMK-2B, and the two OCA COSSs) are 10.1%, 12.3%, 13.8%, and 12.9% (compared to the 9.11% system rate of return at the full revenue requirement). *See OCA Main Brief, at 7.*

<b>PPL Revenue Allocation with both OSBA FDR Proposals</b>		
<b>\$77.5 Million Settled Revenue Requirement (in thousands)</b>		
	<i>OSBA Preferred</i>	<i>OSBA Alternative</i>
RS	\$99,400	\$81,974
RTS	2,086	1,634
GS-1	(7,695)	(6,000)
GS-3	(14,634)	0
LP-4	(1,016)	(179)
ISP	210	180
LP-5	18	34
LP-6	(12)	(8)
LPEP	(143)	(135)
GH	(159)	0
SL/AL	(557)	0
<b>Total</b>	<b>\$77,500</b>	<b>\$77,500</b>

The OSBA's alternative would move the GS-1 and LPEP classes closer to their cost of service than the proportional scaleback recommended by the ALJ. However, as shown in the table above, the OSBA's alternative would impose a substantially smaller rate increase on the residential class (\$83.608 million v. \$101.486 million). Significantly, the OCA proposed an \$89.800 million increase for the residential classes at the Company's full revenue requirement. *See OCA Main Brief*, at 9. Since the OCA considered an \$89.800 million increase to be consistent with the principle of gradualism, the OSBA's proposal for a smaller, \$83.608 million increase must also satisfy the OCA's interpretation of the principle of gradualism.

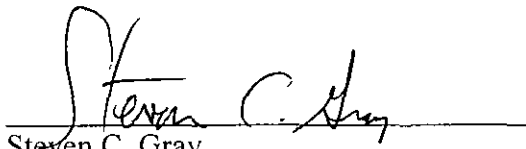
If the Commission rejects the full FDR proposal advocated by the OSBA, the OSBA respectfully requests that the Commission provide additional rate relief for the overpaying GS-1 and LPEP customer classes by approving the OSBA's alternative FDR proposal.

IV. CONCLUSION

In view of the foregoing, the OSBA respectfully requests that the Commission:

1. Grant OSBA Exception No. 1;
2. Grant OSBA Exception No. 2, or, in the alternative, grant OSBA Exception No. 3; and
3. Grant such other relief as may be necessary.

Respectfully submitted,



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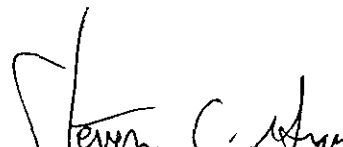
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