

COMMONWEALTH OF PENNSYLVANIA



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November 15, 2010

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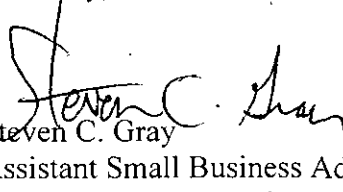
**Re: Pennsylvania Public Utility Commission v. PPL Electric Utilities
Corporation
Docket No. R-2010-2161694**

Dear Secretary Chiavetta:

Enclosed for filing are the original and nine (9) copies of the Reply 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,


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 :

REPLY EXCEPTIONS
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

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Dated: November 15, 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 April 29, 2010, the Office of Small Business Advocate (“OSBA”) filed a complaint against the proposed rate increase. Other parties filing complaints, interventions, or appearances include the Office of Consumer Advocate (“OCA”), the Office of Trial Staff (“OTS”), the Sustainable Energy Fund (“SEF”), the Commission on Economic Opportunity (“CEO”), PP&L Industrial Customer Alliance (“PPLICA”); Citizens for Pennsylvania’s Future (“PennFuture”); Retail Energy Supply Association (“RESA”), International Brotherhood of Electrical Workers, Local 1600 (“IBEW”), and Richards Energy Group (“Richards”).

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

On November 4, 2010, the OSBA, the OCA, SEF, PPLICA, CEO, and RESA filed Exceptions to the ALJ's RD.

The OSBA files these Reply Exceptions in response to the Exceptions filed by the OCA.

II. REPLY EXCEPTIONS

A. Reply to OCA Exception No. 1: The ALJ properly recommended adoption of PPL's new cost of service study as the starting point for allocation of the rate increase in this proceeding. (OCA Exceptions, at 8-20)

1. Summary

PPL proposed a new cost of service study ("COSS") methodology for use in allocating the full revenue requirement in this proceeding. PPL's new COSS is set forth in PPL Exhibit JMK-2A. For illustrative purposes, PPL also filed a COSS (PPL Exhibit JMK-2B) which is based on the methodology the Company used in prior cases. The ALJ recommended adoption of the new COSS, *i.e.*, JMK-2A. RD, at 46. The OCA excepted to the ALJ's recommendation. OCA Exceptions, at 8-20.

2. PPL's Cost of Service Studies

The OCA summarized its arguments against the use of PPL's new COSS, as follows:

PPL's new COSS embodied in JMK-2A is flawed because it does not accurately reflect cost causation. In addition, the Company has proposed a major modification in its cost of service methodology that is not reasonable at this time. The Company's 2010 CCOSS JMK-2A, as a result, should not be used as a guide for setting rates in this proceeding.

OCA Exceptions, at 20.

The OCA summarized the new COSS presented by PPL in this proceeding, as follows:

The Company presented two cost of service studies in this proceeding. The first study, presented in its filing for the first time and updated throughout the course of the proceeding is the Company's new study which it prefers to use in this proceeding. Under its new study, the Company classifies both its Primary and Secondary distribution plant as both customer-related and demand related.

* * *

The ALJ identified the Company's new study as JMK-2A.

OCA Exceptions, at 8.

The OCA then acknowledged that the other COSS submitted by the Company is based on the COSS methodology used by PPL in its last two base rate cases prior to this proceeding.

In the rebuttal phase of this proceeding, the Company submitted another cost of service study that Company witness Kleha testified was 'exactly the same cost allocation methodology as it used in its prior base rate proceedings.'

OCA Exceptions, at 9 (quoting PPL Statement No. 7-R, at 10). The OCA recapped the PPL COSS used in the Company's two previous base rate cases, as follows:

Under this prior methodology (PPL 2004/2007 method), PPL classified its Primary distribution plant as 100% demand-related and its Secondary distribution plant as partially demand-related and partially customer-related.

* * *

This study using PPL's prior methodology from its 2004/2007 base rate proceedings was identified as JMK-2B.

OCA Exceptions, at 9.

The OCA's summaries of the major differences between JMK-2A and JMK-2B are correct. The COSS used by PPL in its two previous base rates cases, *i.e.*, JMK-2B, classified 100% of the Primary Distribution plant on a demand basis.¹ The new COSS presented by PPL in this proceeding, *i.e.*, JMK-2A, classifies the Company's Primary Distribution plant on both a demand and customer basis.

The JMK-2B COSS methodology has been used by the Company for many years and has been previously approved by the Commission. *See, e.g., Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation*, Docket No. R-00049255 (Order entered

¹ The OCA referred to the COSS set forth in Exhibit JMK-2B as the "PPL 2004/2007 method." The ALJ referred to this COSS as "JMK-2B."

December 22, 2004), at 81-82. The JMK-2B COSS recognizes that Secondary voltage distribution plant is causally related to both peak demand and number of customers. Significantly, the JMK-2A COSS proposed by PPL in this proceeding is conceptually consistent with the JMK-2B methodology. The Company proposed in JMK-2A simply to extend the classification split used for Secondary distribution plant (*i.e.*, using both demand and customer components) to Primary distribution plant. As several witnesses observed, this change is consistent with the NARUC Electric Utility Cost Allocation Manual. *See, e.g.*, OSBA Statement No. 1, at 21.

Although its Exception No. 1 is based on criticism of PPL's new COSS methodology, the OCA actually rejected the fundamental principle upon which PPL has historically relied (and which the Commission has previously approved), *i.e.*, that Secondary distribution plant costs should be classified into both demand and customer components. The OCA stated as much in its Exceptions:

The OCA submits that the Company's classification of a majority of both its Primary and Secondary Distribution plant on a customer basis is seriously flawed in several respects.

OCA Exceptions, at 9. Essentially, the fundamental disagreement that the OCA has with PPL with respect to COSS methodology can be summarized as follows: The OCA simply does not believe that *any* joint use distribution plant (poles, conductors, conduit, transformers and related

equipment) costs should be classified based upon the number of customers. OCA Statement No. 1, at 14; OSBA Statement No. 2, at 2; OCA Exceptions, at 10-13.²

In support of PPL's methodology, OSBA witness Mr. Knecht explained that joint use distribution costs are incurred for two reasons, to meet the peak load of customers served by that plant, and to interconnect each customer served by the utility with the transmission grid. For that reason, Mr. Knecht testified that joint use distribution plant costs are related to both peak demand and number of customers. Mr. Knecht further observed that the NARUC Electric Utility Cost Allocation Manual recognizes this principle and specifies that joint-use electric distribution plant costs should be classified into both demand-related and customer-related components (with the exception of substation costs, which should be classified as 100% demand-related). OSBA Statement No. 1, at 14-15.

In an apparent attempt to avoid the recommendation of the NARUC Manual, the OCA disputed the Manual's significance, as follows:

The OCA submits that [the] ALJ's reliance on the NARUC manual to support adoption of the Company's new cost of service study methodology is misplaced in this instance. The NARUC manual provides a generalized guide for generic use – it does not, nor could it, recognize the impact of its recommendations in every instance for every utility service territory.

² The OCA also cited to the results of three alternative COSSs (included by PPL witness Joseph Kleha in PPL Exhibit JMK-5) for the proposition "that the Company's new cost of service methodology produces the lowest return for the residential customer class of any of the studies." OCA Exceptions, at 5. That may be true. However, as Mr. Knecht explained, PPL's three alternative COSSs do not provide any "useful information for revenue allocation and rate design in this proceeding." OSBA Statement No. 1, at 21. Mr. Knecht explained as follows:

None of these scenarios is based on any specific analysis of how PPL Electric incurs costs. As such, these scenarios are a simple exercise in demonstrating that a computer model can produce widely varying results when it uses inputs that are not based on any credible analysis. As I explained earlier, no electric distribution costs are causally related to energy consumption. As such, Scenarios 2 and 3 are not relevant. Scenario 1 differs only slightly from the Company's filed proposal, and therefore adds little insight into costs incurred to serve each rate class.

OSBA Statement No. 1, at 22.

OCA Exceptions, at 13. However, as even the OCA admitted, the NARUC Manual does provide a guide for the design of a COSS. The NARUC Manual provides a reasonable, time-tested foundation upon which a utility company, such as PPL, can construct a cost of service methodology. The mere fact that the OCA does not agree with the NARUC methodology on some point does not lessen the value of the guidance provided by the Manual. Adopting the OCA's approach would abandon the effort to achieve a reasonable degree of objectivity and would invite selective "picking and choosing" from the Manual, depending on the revenue allocation outcome desired.

Furthermore, the OCA did not dispute that the COSS methodology previously used by PPL, *i.e.*, JMK-2B, also includes a customer component. OCA Exceptions, at 9. The JMK-2B COSS was used in both the 2004 and 2007 PPL base rate proceedings. *Id.* The OCA has presented no evidence that the Commission, in either of these two cases, found the PPL JMK-2B COSS methodology to be defective or in any manner unreasonable.

3. The OCA Cost of Service Study

Rather than using either PPL's JMK-2A or JMK-2B, the OCA argued in favor of using the COSS developed by its witness, Glenn A. Watkins, as follows:

OCA witness Watkins' study properly allocates costs in a more accurate and reasonable manner that is reflective of cost causation on the PPL system. The OCA submits that Mr. Watkins' study, when viewed in conjunction with PPL's own 2004/2007 Method study and Mr. Watkins' and PPL's peak and average studies, provides a useful guide for setting rates in this proceeding.

OCA Exceptions, at 20.

The OCA identified Mr. Watkins' COSS methodology, as follows:

OCA witness Watkins performed two cost of service studies that corrected certain errors in PPL's study, adjusted specific account

allocators, and classified distribution plant other than ‘services and meters’ on the basis of 100% demand. For his preferred study, Mr. Watkins allocated the Primary and Secondary distribution plant based on each class’ non-coincident peak (NCP) demand. For his second study, Mr. Watkins allocated Primary and Secondary distribution plant partially on peak usage and partially on average usage (a ‘peak and average’ study).

OCA Exceptions, at 16-17 (footnote omitted).

Mr. Watkins’ preferred COSS uses “a 100% demand classification for Primary and Secondary distribution plant as opposed to a study that classifies these facilities as partially customer-related.” OCA Exceptions, at 17. Mr. Watkins does not believe that there should be any joint use distribution plant costs classified on the basis of the number of customers. *Id.*, at 17-18.

The OCA’s exception relied heavily on the complaint that the ALJ relied solely on the NARUC Manual for determining the appropriate cost allocation method in this proceeding. However, the OCA’s exception presented no explanation as to why the theories of Mr. Watkins should overrule both Commission precedent and the NARUC Manual with respect to the allocation method for PPL’s distribution plant. In fact, Mr. Watkins presented his theories in his direct testimony, and Mr. Watkins theories were extensively rebutted by Mr. Kleha, Mr. Knecht, and PPLICA witness Mr. Richard A. Baudino. *See* PPL Statement No. 7-R, at 10-15; OSBA Statement No. 2, at 2-10; PPLICA Statement No. 2-R, at 1-7. All of these witnesses presented evidence that the NARUC Manual methodology is consistent with cost causation and is appropriate for use in this proceeding. Therefore, the Commission should reject the OCA’s conclusion that the ALJ relied solely on the NARUC Manual, in that the record evidence demonstrates that the use of the NARUC Manual’s method is well-justified.

In the end, the OCA's exception boils down to the curious claim that its proposed COSS methodology is somehow more consistent with the PPL prior method than other methodologies.

The OCA claimed, as follows:

Mr. Watkins [sic] study most closely aligns with the Company's allocation methodology from 2004 and 2007.

OCA Exceptions, at 20. The OCA's contention is neither correct nor relevant.

First, it is a tautology that the COSS that is most closely aligned with PPL's JMK-2B is, in fact, the JMK-2B COSS. The JMK-2B COSS is contained in the record of this proceeding.

Second, as a conceptual matter, the Company's proposed changes to its prior cost allocation methodology were consistent with the cost causation principles it has used in the past. As Mr. Kleha explained, PPL had not heretofore made these changes because it had not conducted the analysis necessary to do so. PPL Statement No. 7-R, at 9. As such, the COSS presented in Exhibit JMK-2A is conceptually consistent with the cost causation principles adopted by the Commission in the past. Using Mr. Watkins' COSS, by contrast, would require the adoption of a wholly new conceptual framework for cost causation, by pretending that there is no aspect of cost causation for joint use distribution facilities that is related to number of customers.

Third, by removing the number of customers as a factor in its COSS and focusing solely on demand, the OCA COSS will assign costs to the RS residential class (which has a large number of customers) and the GS-3 class (which has higher demand) much differently than will the PPL JMK-2B COSS. The table below, which displays class rates of return (at present rates), demonstrates this fact.

TABLE 1

Rate Schedule	OCA Method	PPLExhibit JMK-2B
RS	6.13%	5.33%
RTS	-4.74%	-4.72%
GS-1	12.89%	12.36%
GS-3	7.01%	10.49%
LP-4	2.09%	1.77%
ISP	-0.02%	-0.33%
LP-5	-12.14%	-23.49%
LP-6	-11%	-66.95%
LPEP	16.6%	15.33%
GH	3.61%	6.09%
SL/AL	11.09%	8.56%
Total	6.33%	6.29%

OCA Main Brief, at 34, Exhibit JMK-2B. at 83-84.³ See also, OCA Exceptions, at 18.

Even though the OCA claimed that Mr. Watkins' study "most closely aligns" with PPL's JMK-2B, the differences between the OCA COSS results and the PPL COSS results are substantial. A simple examination of the rates of return for the RS and GS-3 classes demonstrates significant differences. At present rates, the RS class is materially underpaying its cost of service, by 96 basis points (6.29% - 5.33%), under the PPL JMK-2B COSS. However, under the OCA COSS, the RS class is underpaying its cost of service by only 20 basis points

³ The OSBA observes that at page 34 of its Main Brief, the OCA reports class rates of return at present rates based on the PPL 2004/2007 Method, which relies on OCA witness Mr. Watkins' surrebuttal testimony (OCA St. 3-S), which itself relied upon a COSS filed in response to OSBA-I-8. However, as Mr. Kleha indicated in his rebuttal testimony, Exhibit JMK-2B updated and corrected the COSS filed in response to OSBA-I-8, and is therefore a more accurate reflection of the prior methodology. PPL Statement No. 7-R at 10. Exhibit JMK-2B was available both to Mr. Watkins for surrebuttal and to OCA for its Main Brief, but both chose to use the less accurate values. In order to avoid confusing the record, the actual results from Exhibit JMK-2B are reported in the table above.

(6.33% - 6.13%). Conversely, the GS-3 class goes from overpaying its cost of service by 420 basis points under the PPL JMK-2B COSS (10.49% - 6.29%) to overpaying its cost of service by a relatively modest 68 basis points (7.01% - 6.33%) under the OCA COSS.

It is also worth noting the dramatically different results for the GH class under the two COSSs, *i.e.*, a 3.61% rate of return under the OCA COSS compared to a 6.09% rate of return under the PPL JMK-2B COSS.

In view of the foregoing comparison, there is no basis for a finding that Mr. Watkins' COSS "most closely aligns" with the PPL JMK-2B COSS, either conceptually or numerically. The difference between the underlying methodologies, *i.e.*, whether to classify any joint use distribution plant costs based on customer counts, is so fundamental that it materially changes the assignment of costs to the residential and commercial classes and materially changes the allocation of the rate increase at the full revenue requirement.

Therefore, the OSBA respectfully requests that the Commission deny OCA Exception No. 1 and uphold the ALJ on the issue of adopting the Company's JMK-2A COSS in this proceeding.

4. "Moving the Goal Line"

In addition to objecting to how the new PPL COSS classifies Primary distribution plant, the OCA also complained that the Company's decision to use JMK-2A rather than JMK-2B in this proceeding "moved the goal line just as the residential customer class was reaching it."

OCA Exceptions, at 3. The OCA explained its position, as follows:

As the ALJ and all of the parties recognized, under the Settlement of the PPL 2004 base rate proceeding remand, PPL agreed to a plan that would move the distribution service class rates of return to 'at or near' the full cost of service over three rate proceedings, subject to three caveats. The 2004 base rate proceeding was the first, the 2007 base rate proceeding was the second, and the current

filing is the third of the three rate cases. In this case, however, PPL made a material change to the methodology it had previously employed to conduct its cost of service study, which informs the decision as to whether customer classes are 'at or near' the full cost of service as determined by that study. The change in methodology implemented by PPL for this proceeding significantly increased the amount of costs assigned to the residential customer class as compared to its prior methodology. As a result, despite having shown significant progress towards cost of service in the prior two cases, the residential class now seemed to move backwards, *i.e.*, the return provided by the residential class was getting lower rather than higher despite paying disproportionately higher increases in the 2004 base rate case remand and the 2007 base rate settlement.

OCA Exceptions, at 1-2.

Because PPL's prior COSS methodology included a customer component for classifying Secondary distribution plant, the OCA's objection to "moving the goal line" essentially *conceded that using a customer component for classifying Secondary distribution plant is acceptable in this proceeding.* Therefore, if the Commission agrees with the OCA that PPL has improperly moved the "goal line" in this case, the option supported by the record is to adopt the COSS methodology the Company was using when it promised to move classes to at or near their cost of service. Consequently, if the Commission agrees with OCA in this respect, the Commission should use the JMK-2B COSS, rather than the OCA COSS, as the starting point for allocating the revenue requirement in this proceeding.⁴ Moreover, if the Commission does agree with keeping the "goal line" fixed, it should also move rates for all rate classes fully into line with allocated cost in this proceeding, which was PPL's commitment upon which OCA relied in its exception.

⁴ If the OCA is correct that PPL is improperly moving the "goal line" in this proceeding, it would be equally improper to move the "goal line" in a different direction by adopting the OCA COSS.

B. Reply to OCA Exception No. 2: The ALJ properly rejected the OCA’s proposal to allocate the revenue increase in this proceeding. (OCA Exceptions at 21-29)

In its Exceptions, the OCA stated as follows:

The OCA’s proposed allocation of the revenue increase is reasonable under the Company’s prior cost of service methodology and under the OCA’s cost of service methodology. Therefore, the OCA’s revenue allocation should be accepted.

OCA Exceptions, at 21.

The OCA’s proposed revenue allocation is based upon OCA witness Mr. Watkins’ preferred COSS. As explained above in response to OCA Exception No. 1, Mr. Watkins’ COSS does not include number of customers as a classification factor for joint use distribution plant costs. Consequently, the OCA revenue allocation is radically different than that proposed by PPL, which relied upon the JMK-2A COSS. As OSBA witness Mr. Knecht succinctly stated, “The overwhelming factor contributing to the different revenue allocation proposals is the cost allocation analyses upon which we rely.” OSBA Statement No. 2, at 11.

The OCA’s proposed revenue allocation, at PPL’s full revenue requirement, is set forth below:

TABLE 2

Class	(\$000)
Residential (RS, RTS)	\$89,800
GS-1	\$0
GS-3	\$16,166
LP-4/ISP	\$7,036
LP-5/LP-6	\$290
LPEP	\$0
GH	\$1,382
Lighting	\$0
Total	\$114,675

OCA Exceptions, at 23.

The rate increase assigned to the GS-3 customer class by the OCA's proposed allocation contradicts the OCA's assertion that the OCA COSS "most closely aligns" with the PPL JMK-2B COSS. OCA Exceptions, at 20.

As set forth above in Table 1, the PPL JMK-2B COSS shows that the GS-3 customer class has a rate of return of 10.49% at present rates. OCA Exceptions, at 18. In its original filing, the Company's revenue requirement was based on a system average rate of return of 9.11% at proposed rates. Because the GS-3 class is already paying in excess of 9.11% at present rates under the PPL JMK-2B COSS, moving rates for this class into line with allocated cost would require a *rate reduction*, not a rate increase. Yet, at the Company's full revenue requirement, the OCA proposed to assign the GS-3 customer class a \$16.166 million increase. OCA Exceptions, at 23. Contrary to the OCA's assertion, the OCA COSS and the PPL JMK-2B COSS do not provide results that are in "close alignment." Instead, when judged by PPL's JMK-

2B COSS, the OCA's revenue allocation would make an overpaying class overpay even more. The Commonwealth Court rejected this notion in *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010 (Pa. Cmwlth. 2006), *appeals denied*, 916 A.2d 1104 (Pa. 2007).

Furthermore, as discussed above in response to OCA Exception No. 1, the OCA argued that PPL improperly changed the Company's COSS methodology in this proceeding and, as a result, "moved the goal line just as the residential customer class was reaching it." OCA Exceptions, at 3. If the Commission decides that the OCA's objection to changing the COSS methodology in this proceeding is valid, the Commission should not remedy the problem by adopting the OCA's COSS and revenue allocation, thereby allowing the *OCA* to move the goal line. Contrary to the OCA's implication, its COSS and revenue allocation would not leave the goal line where it was when PPL promised to move classes to at or near their cost of service. Rather, the OCA's COSS and revenue allocation would move the goal line in a way that favors the residential classes.

If it agrees with the OCA's objection, the Commission should rely entirely on the PPL JMK-2B COSS for the revenue allocation in this proceeding. That is, the Commission should direct PPL to establish rates at PPL's full proposed revenue requirement which exactly recover the costs allocated in Exhibit JMK-2B, including the imposition of rate reductions to those rate classes whose revenues currently exceed the costs allocated in that COSS. This approach would be consistent with PPL's promise in the 2004 base rates remand proceeding. The Commission should then direct PPL to scale back the \$114.675 million increase at the full revenue requirement to the \$77.5 million revenue requirement embodied in the settlement.

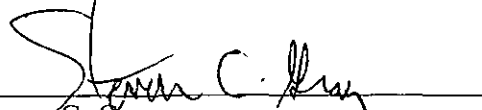
Therefore, the OSBA respectfully requests that the Commission deny OCA Exception No. 2 and uphold the ALJ in denying the OCA's proposed revenue allocation in this proceeding.

In the alternative, if the Commission does find merit in the OCA's argument that PPL has "moved the goal line" in this proceeding, the OSBA would support the adoption of PPL's previous COSS, Exhibit JMK-2B, in this proceeding and a revenue allocation based exactly on Exhibit JMK-2B.

III. CONCLUSION

For the reasons set forth herein, the OSBA respectfully requests that the Commission deny OCA Exceptions Nos. 1 and 2.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Steven C. Gray", is written over a horizontal line.

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Dated: November 15, 2010

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Reply Exceptions, on behalf of the Office of Small Business Advocate, by e-mail and first-class mail (unless otherwise noted) upon the persons addressed below:

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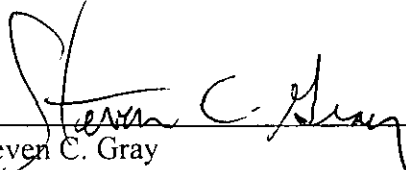
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