

COMMONWEALTH OF PENNSYLVANIA



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October 26, 2011

Hand Delivery

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

**Re: William R. Lloyd, Jr., Small Business Advocate v. PPL Electric Utilities Corporation
Docket No. C-2011-2245906**

**PPL Electric Utilities Corporation Calculation of Generation Supply Charge-1
Docket No. M-2011-2243137**

Dear Secretary Chiavetta:

Enclosed for filing are the original and ten (10) copies of the Main Brief, on behalf of the Office of Small Business Advocate, in the above-docketed proceedings. 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 contact me.

Sincerely,

A handwritten signature in cursive script that reads "Elizabeth Rose Triscari".

Elizabeth Rose Triscari
Assistant Small Business Advocate
Attorney ID #306921

Enclosures

cc: Parties of Record

Robert D. Knecht

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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| William R. Lloyd, Jr., Small Business Advocate | : | |
| v. | : | DOCKET NO. C-2011-2245906 |
| PPL Electric Utilities Corporation | : | |
| PPL Electric Utilities Corporation Calculation of Generation Supply Charge-1 | : | DOCKET NO. M-2011-2243137 |

**MAIN BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE**

**Elizabeth Rose Triscari
Assistant Small Business Advocate
Attorney ID # 306921**

**For: William R. Lloyd, Jr.
Small Business Advocate
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**Office of Small Business Advocate
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Dated: October 26, 2011

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I. Factual and Procedural Background

A. Competitive Bridge Plan and Default Service Plan

On May 17, 2007, the Commission entered an Order at Docket No. P-00062227 approving the Competitive Bridge Plan (“CBP”) for PPL Electric Utilities Corporation (“PPL” or “Company”) to provide default service for calendar year 2010.

The CBP Order provided for recovery and quarterly reconciliation of default service generation supply costs pursuant to a Generation Supply Charge (“GSC”).¹ The Company anticipated that the effect of reconciliation would be minor because all of the electricity for default service customers would be procured through full-requirements contracts entered in 2008, 2009, and 2010. Therefore, the cost of the electricity would be known in advance and the wholesale suppliers (rather than PPL) would bear the risk of changes in load caused by shopping, weather, the economy, and other similar factors.²

The CBP was followed by PPL’s default service plan to provide default service for January 1, 2011, through May 31, 2013 (“DSP”). The DSP was approved by Commission Order entered on June 30, 2009, at Docket No. P-2008-2060309. The DSP continued to provide for recovery and quarterly reconciliation of default service generation supply costs, but it did so through a Generation Supply Charge-1 (“GSC-1”) for residential and small commercial and industrial (“SC&I”) customers and a Generation Supply Charge-2 (“GSC-2”) for large commercial and industrial customers.³

¹ See OSBA Exhibit B at 53-54.

² OSBA Statement No. 1 at 4, fn. 4, quoting PPL witness Joseph M. Kleha’s testimony.

³ The GSC-1 provides for an SC&I “Fixed” rate, as well as on-peak and off-peak Time of Use (“TOU”) rates. Because the vast majority of SC&I customers take “Fixed” rate service, references hereafter to the GSC-1 for SC&I customers are to the GSC-1 SC&I Fixed rate. The OSBA notes, however, that PPL’s well-known problems with its TOU rates are likely due, at least in part, to the reconciliation accounting issues addressed in this brief.

On December 11, 2009, at Docket No. M-2009-2145482, PPL submitted a final calculation of the proposed GSC for the first quarter of 2010 in the amount of 10.125 cents per kWh (including Gross Receipts Tax or “GRT”) for SC&I customers.⁴

B. No Reconciliation During 2010

On March 1, 2010, PPL submitted its proposed GSC for the second quarter of 2010, which included a reconciliation of actual and estimated costs for January 2010. This filing reported a \$33 million undercollection from SC&I customers for January 2010.⁵

On March 8, 2010, PPL submitted a letter to the Commission regarding the proposed GSC for the second quarter of 2010.⁶ In that letter, PPL concluded that the significant undercollection “is not representative of a true over/undercollection.”⁷ The letter acknowledged that the reported undercollection was due to its reconciliation accounting method of prorating billed revenue in January 2010. The letter also stated that the January 2010 undercollection was expected to be balanced out as a result of a similar proration adjustment in January 2011.⁸ PPL further admitted in the March 8 letter that it was experiencing billing problems for a variety of reasons.⁹

Because of the proration undercollection and the other billing problems, PPL requested to withdraw the proposed change to the GSC for the second quarter of 2010 and continue the first quarter GSC until July 1, 2010. PPL further requested to defer quarterly reconciliation until the

⁴ OSBA Statement No. 1 at 4-5; *see also* PPL Electric Hearing Exhibit No. 1.

⁵ OSBA Statement No. 1 at 5.

⁶ Exhibit IEc-2, attached to OSBA Statement No. 1.

⁷ *Id.* at 1.

⁸ *Id.* at 1-2.

⁹ *Id.* at 2.

third quarter of 2010. PPL also proposed to defer recovery of the January 2010 proration undercollection until January 2011.¹⁰

When PPL made its subsequent GSC filings for the third and fourth quarters of 2010, PPL again requested Commission approval to defer reconciliation and recovery of reported undercollections and to continue the first quarter GSC rate of 10.125 cents per kWh.

The Commission approved each of these requests, resulting in no reconciliation charges to ratepayers and no change to the GSC in 2010.¹¹

C. Calculation of GSC-1 for January – May 2011 Period

On December 14, 2010, PPL submitted a calculation of the proposed GSC-1 for January through May of 2011 at Docket No. M-2010-2213310.¹² For the SC&I class, the GSC-1 was set at 9.276 cents per kWh (including GRT).¹³ This rate was intended to recoup PPL's estimated electricity purchase costs (8.293 cents per kWh) as well as a reported year-end 2010 undercollection of \$22.35 million by the end of May 2011 (0.983 cents per kWh). The reported year-end undercollection included the effects of the difference between billed revenues and incurred costs, as estimated at December 31, 2010.¹⁴ Following Commission approval, PPL's recovery of reported 2010 undercollections began on January 1, 2011.

On May 13, 2011, at Docket No. M-2011-2240273, PPL submitted its "Final 2011 Generation Supply Charge-1 Reconciliation Report, for the Period January 1, 2011 to May 31,

¹⁰ *Id.*

¹¹ OSBA Statement No. 1 at 5-6.

¹² *Id.* at 6.

¹³ *Id.*

¹⁴ *Id.* The estimated year-end undercollection included actual undercollections through November 2010, plus an estimate for December 2010.

2011” (“Reconciliation Report”).¹⁵ The Reconciliation Report represented that the actual 2010 undercollection was approximately \$29.15 million, which was materially larger than the \$22.38 million PPL had previously estimated.¹⁶

D. Calculation of GSC-1, for June – August 2011 Period

On May 20, 2011, PPL filed its calculation of the proposed GSC-1 rates for the period of June 1, 2011, through August 31, 2011, at Docket No. M-2011-2243137.¹⁷ The rate proposed for SC&I customers in the May 20, 2011, filing (“June GSC-1”) is the rate at issue in the instant proceeding. The June GSC-1 was designed to recoup an \$18.6 million reported undercollection from SC&I customers over three months by increasing the GSC-1 from 9.276 cents per kWh to 12.171 cents per kWh (including Gross Receipts Tax or “GRT”). The reconciliation portion of the GSC-1 calculation included recovery of a \$4.28 million reported undercollection from the January to May 2011 period (inclusive of the December 2010 “true-up”). The calculation also included \$14.27 million remaining from the reported year-end 2010 undercollection, which PPL had not recovered in the first five months of 2011 as anticipated. Of the 12.171 cents per kWh SC&I GSC-1, 4.15 cents per kWh was related to PPL’s reported undercollection of costs in previous periods.¹⁸

¹⁵ OSBA Statement No. 1 at 6-7.

¹⁶ On June 9, 2011, the OSBA intervened in the Reconciliation Report proceeding. A hearing was held with respect to the Reconciliation Report on June 13, 2011. At the hearing, PPL stipulated orally that the outcome of that proceeding was without prejudice to the OSBA’s complaint in this proceeding. ALJ Colwell’s Recommended Decision reflected the agreement between PPL and the OSBA that the OSBA has not waived raising any issues in the instant proceeding because they were not raised in the Reconciliation Report Proceeding. Recommended Decision (dated July 11, 2011) at 2, at Docket No. M-2011-2240273. The Recommended Decision was adopted by Commission Order entered September 12, 2011.

¹⁷ OSBA Statement No. 1 at 7.

¹⁸ *Id.*

On May 26, 2011, PPL filed Supplement No. 106 to its tariff. Supplement No. 106 reflects the proposed June GSC-1, as well as changes to the Act 129 Compliance Rider (“ACR”) and to the Transmission Service Charge (“TSC”). Supplement 106 is purported to have been “filed in compliance with the Commission’s Secretarial Letters, entered on May 19, 2011, at Docket Nos. M-2011-2240233 and M-2011-2239841, its Order, entered on May 25, 2011, at Docket No. M-2011-2239805, as well as Docket No. M-2011-2243137.”¹⁹

However, none of the Secretarial Letters or the Order cited by PPL approves or even mentions implementation of the proposed June GSC-1.

- The Secretarial Letter at Docket M-2011-2240233 relates to the GSC-2, despite the fact that Supplement No. 106 did not reflect any changes to the GSC-2.
- The Secretarial Letter at Docket M-2011-223984 relates to the ACR.
- The May 25 Order deals only with the TSC.
- There is also no Secretarial Letter or Order entered at Docket No. M-2011-2243137 (the June GSC-1 docket), or at any other docket, authorizing the GSC-1 rate change contained in Supplement No. 106.

On May 31, 2011, the OSBA filed a Complaint against the proposed June GSC-1. The Company filed its Answer to the OSBA’s Complaint on June 29, 2011. The Office of Administrative Law Judge assigned this proceeding to Administrative Law Judge (“ALJ”) Susan D. Colwell.

The Office of Trial Staff, now part of the Bureau of Investigation and Enforcement (“BI&E”), filed a notice of appearance on June 22, 2011. The Office of Consumer Advocate (“OCA”) filed a Notice of Intervention on July 12, 2011.

¹⁹ Supplement No. 106 to Tariff – Electric Pa. P.U.C. No. 201 at Notice Page 1, filed May 26, 2011, at Docket Nos. M-2011-2240233 (GSC-2 docket), M-2011-223984 (ACR docket), and M-2011-2239805 (TSC docket). Supplement No. 106 is not filed at Docket No. M-2011-2243137 (June GSC-1 docket).

The OSBA submitted OSBA Statement No. 1 (the Direct Testimony and Exhibits of Robert D. Knecht) and OSBA Statement No. 2 (the Surrebuttal Testimony of Robert D. Knecht) on July 29, 2011, and August 25, 2011, respectively. PPL submitted Direct Testimony, Rebuttal Testimony, and Rejoinder Testimony. Neither the OCA nor the BI&E filed testimony.

The hearing originally scheduled for August 29, 2011, was continued. It was subsequently held on October 5, 2011, at which time OSBA Statement No. 1 and OSBA Statement No. 2 were entered into the record, along with OSBA Exhibits A, B, C, D, and E.²⁰

It was agreed to by the parties (and approved by ALJ Colwell at the hearing) that due to the continuance, the procedural schedule would be altered to have Main Briefs due on October 26, 2011, and Reply Briefs on November 9, 2011.

The OSBA submits this Main Brief in accordance with that altered procedural schedule.

²⁰ OSBA Exhibit A, PPL Responses to OSBA-PPL Interrogatory IV-1; OSBA Exhibit B, Opinion and Order at Docket No. P-00062227, entered May 17, 2007, pp. 48-54; OSBA Exhibit C, Supplement No. 55 to Tariff Electric Pa. P.U.C. No. 201, filed at Docket No. P-00062227 on May 22, 2007, pp. 19Z.2-19Z.3; OSBA Exhibit D, Generation Supply Charge Rider, Tariff Electric – Pa. P.U.C. No. 201, pp. 19Z.2-19Z.3F; and OSBA Exhibit E, Generation Supply Charge-1 Rider, Tariff Electric – Pa. P.U.C. No. 201, pp. 19Z.4-19Z.5D.

II. Summary of Argument

From June 1 through August 31, 2011, PPL imposed a generation rate on its SC&I default service customers that was not just and reasonable. Specifically, the June GSC-1 was 31% higher than the rate for the prior 5 months. The 31% increase was not caused by any increase in generation costs incurred by PPL, but rather was caused by a 4.15 cent per kWh reconciliation charge. The reconciliation charge was designed to recoup the balance of a substantial reported undercollection of generation costs for 2010 of more than \$29 million. The OSBA does not dispute that PPL is entitled to recover its actual costs for providing default service generation supply in 2010. However, the reported undercollection being recouped by PPL through the June GSC-1 was not a true undercollection. Rather, it was the result of a flawed reconciliation accounting method and PPL's apparent under-reporting of revenues.

PPL's proration accounting method is inconsistent with the fundamental accounting principle of matching costs and revenues. Specifically, PPL matches 12 months of *incurred* costs with 11½ months of *billed* revenues, instead of with 12 months of *earned* revenues. The ½ month of earned, but unbilled, revenues is not included in PPL's reconciliation calculation. This mismatch created a false 2010 undercollection that PPL then began recouping from ratepayers through the GSC-1 in January 2011.

Perhaps even more troubling, the undercollection that resulted from PPL's accounting method does not explain the entire reported 2010 undercollection. At least \$14 million of that \$29 million undercollection cannot be attributed to proration. A review of PPL's revenues for 2010 revealed that an apparent under-reporting of revenues may account for the unexplained shortfall. This conclusion is based on the fact that the per-kWh revenues reported by PPL are not consistent with the tariff rates charged. Only the Company is in a position to explain this variance, which PPL has not adequately done. Therefore, a detailed audit by the Commission's

Bureau of Audits, focusing explicitly on the issues identified by the OSBA in this proceeding, is necessary to evaluate PPL's default service cost and revenue records for 2010 properly.

If the Commission rejects PPL's proration accounting method, the Commission should retroactively modify the June GSC-1 rate charged and direct PPL to make appropriate refunds to its default service customers. Similarly, if the detailed audit fails to justify the apparent under-reporting of SC&I revenues, the Commission should retroactively modify the June GSC-1 rate charged and direct PPL to make appropriate refunds to its default service customers.

The Commission has the authority to order refunds because the June GSC-1 is not a "Commission-made" rate. It was billed and collected without a hearing or adjudication by the Commission. As such, it is not insulated from retroactive modification.

III. Burden of Proof

Section 1301 of the Public Utility Code requires that “[e]very rate made, demanded, or received by any public utility... shall be just and reasonable.”²¹ Section 315(a) of the Public Utility Code states in pertinent part, “in any proceedings upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.”²² As the public utility proposing the June GSC-1, PPL bears the burden of proving that such rate is just and reasonable.

A utility company has the burden of proof to show the reasonableness of a *proposed* rate, whereas a complainant bears the burden if the rate is an *existing* one. In *Brockway Glass Co. v. Pennsylvania Public Utility Commission*, the Commonwealth Court explained that “where a customer is heard to complain concerning a *proposed* change in rate, the burden of proof is upon the public utility to show the proposed rate is just and reasonable. Where the complaint involves an *existing* rate, however, the burden then falls upon the customer to prove that the charge is no longer reasonable.”²³ Therefore, the question of which party has the burden of proof in this case turns on whether the June GSC-1 is a Commission-approved, an existing rate, or merely a rate proposed by PPL and subject to Commission review.

The June GSC-1 is not an existing rate that would shift the burden of proof to the OSBA because it was not in effect at the time the OSBA filed its Complaint. Specifically, the OSBA filed its Complaint against the proposed June GSC-1 on May 31, 2011, before the rate went into effect on June 1, 2011. Since as early as 1920, it has been well-established law that if a

²¹ 66 Pa. C.S. § 1301.

²² 66 Pa. C.S. § 315(a).

²³ *Brockway Glass Co. v. Pennsylvania Public Utility Commission*, 437 A.2d 1067, 1070 (Pa. Cmwlth. 1981) (emphasis in original); see also *Cup v. Pennsylvania Public Utility Commission*, 556 A.2d 470, 472 (Pa. Cmwlth. 1989); *Zucker v. Pennsylvania Public Utility Commission*, 401 A.2d 1377, 1379-1380 (Pa. Cmwlth. 1979).

complaint is filed before a proposed rate goes into effect, the utility bears the burden of proving its reasonableness.²⁴

Moreover, the proposed June GSC-1 has never been adjudicated and approved by the Commission. Although PPL has already billed and collected the June GSC-1, it has done so without affirmative Commission authorization. The Commission has issued no Order or Secretarial Letter regarding the proposed June GSC-1, as it has in connection with all previous and subsequent GSC and GSC-1 quarterly reconciliations.²⁵ Unlike every other change to the GSC or GSC-1 rate, the Commission did not approve the proposed June GSC-1 rate and did not direct PPL to submit a tariff supplement implementing revised GSC-1 rates.²⁶ Thus, the June GSC-1 is not a Commission-approved, existing rate and PPL retains the burden of proof.

The Company will likely argue that the June GSC-1 was “pre-approved” by the Commission because PPL followed the reconciliation *procedures* provided for in its tariff to

²⁴ See, e.g., *Suburban Water Co. v. Oakmont Borough*, 110 A. 778, 779 (Pa. 1920) (“On such hearing, where the proceedings have been instituted before the rate has become effective, the public service company must show the rates are reasonable”); *St. Clair Coal Co. v. Public Service Commission*, 79 Pa. Super. 528, 532 (Pa. Super. 1922) (“The complaint having been filed before the rates had become effective, the burden of proof was on the Power Company to sustain them.”); *Scranton-Spring Brook Water Service Co. v. Public Service Commission*, 160 A. 230, 232 (Pa. Super. 1932) (“As complaints were filed before the effective date of the tariff, the burden of proof of the reasonableness of the rates was on the water company.”).

²⁵ See *Secretarial Letter dated December 17, 2009*, at Docket No. M-2009-2145482 (approving proposed GSC rates effective January 1, 2010); *Secretarial Letter dated March 25, 2010*, at Docket No. M-2009-2145482 (approving PPL’s request to waive quarterly change to GSC rates effective April 1, 2010); *Secretarial Letter dated June 16, 2010*, at Docket No. M-2009-2145482 (approving PPL’s request to waive quarterly change to GSC rates effective July 1, 2010); *Secretarial Letter dated September 23, 2010*, at Docket No. M-2009-2145482 (approving PPL’s request to waive quarterly change to GSC rates effective October 1, 2010); *Secretarial Letter dated December 16, 2010*, at Docket No. M-2010-2213310 (approving GSC rates effective January 1, 2011); *Commission Order entered August 25, 2011*, at Docket No. M-2011-2258733 (approving fixed price GSC-1 rates effective September 1, 2011).

²⁶ See *Secretarial Letter dated December 17, 2009*, at Docket No. M-2009-2145482 (directing PPL to submit appropriate tariff reflecting approved revised GSC-1 rate effective January 1, 2010); *Secretarial Letter dated December 16, 2010*, at Docket No. M-2010-2213310 (directing PPL to submit appropriate tariff reflecting approved revised GSC-1 effective January 1, 2011); *Commission Order entered August 25, 2011*, at Docket No. M-2011-2258733 (directing PPL to submit appropriate tariff reflecting approved revised GSC-1 rate effective September 1, 2011).

calculate the June GSC-1.²⁷ The OSBA does not dispute that the Commission has approved the reconciliation *procedures* in PPL’s tariff. However, approval of the *procedures* is not dispositive, in that the OSBA is arguing that PPL has not properly implemented those procedures.

PPL may also point to language in its tariff stating that a proposed GSC-1 shall become effective “unless otherwise ordered by the Commission.”²⁸ The OSBA does not dispute that the June GSC-1 went into effect on June 1, 2011, after the OSBA filed its complaint. However, this fact does not insulate the June GSC-1 from Commission review and does not absolve PPL of its burden to prove that this rate is just and reasonable. In that regard, PPL’s tariff also states, in pertinent part:

Application of the GSC-1 shall be subject to continuous review and audit by the Commission at intervals it shall determine. The Commission shall review the reasonableness and lawfulness of the level of charges produced by the GSC-1 and the costs included therein.²⁹

PPL cannot reasonably interpret its tariff to mean that the Commission, by approving mere reconciliation *procedures*, had prospectively approved not only the June GSC-1, but also the GSC-1 rate for every subsequent quarter. First, the tariff acknowledges that each change to the GSC-1 necessitates a new application to the Commission for review. Second, the tariff requires PPL to file with the Commission a proposed GSC-1 every quarter, thus making the proposed GSC-1 subject to Commission review and complaints by interested parties. Each

²⁷ See PPL Answer at ¶7.

²⁸ OSBA Exhibit E, Generation Supply Charge-1 Rider, Tariff Electric – Pa. P.U.C. No. 201 at 19Z.5D, ¶1.

²⁹ Id. at ¶5.

quarter, PPL retains the burden of proof to show the reasonableness and lawfulness of the proposed GSC-1 for that quarter.

IV. Refunds Are Permitted

Because the June GSC-1 has not been adjudicated by the Commission, it is not a “Commission-made rate” as that term is used in public utility law. The Pennsylvania Supreme Court long ago decided that to be a Commission-made rate, rates must be approved after notice, hearing and adjudication.³⁰ If a rate is not “Commission-made,” a public utility cannot validly expect the charge to be insulated from retroactive modification by the Commission.³¹

Therefore, if the Commission decides that PPL’s proration accounting method produced rates that were not just and reasonable, or if after an audit, the Commission determines that PPL under-reported revenues for 2010, the Commission has the authority to order refunds to SC&I customers.

³⁰ *Cheltenham & Abington Sewerage Co. v. Pa. Public Utility Commission*, 25 A.2d 334, (Pa. 1942) (overturning Commission order requiring utility company to make reparations because Commission had determined the rates to be just and reasonable after notice and hearing).

³¹ *Metropolitan Edison Co., v. Pa. Public Utility Commission*, 437 A.2d 76, 79-80 (Pa. Cmwlth. 1981) (finding concept of “Commission-made rate” did not apply where no prior Commission proceeding or action giving antecedent approval of fuel adjustment surcharge collected).

V. PPL's Reconciliation Accounting Method Is Flawed

A. How the Method Works

PPL has asserted that the primary reason for the substantial 2010 reported undercollection is the result of proration of billings in January 2010. Before arguing the merits of PPL's reconciliation accounting method, it may first be helpful to explain the mechanics of that method.

Beginning January 1, 2010, PPL distributed electricity procured under the CBP to meet the needs of its default service customers. Pursuant to PPL's reconciliation accounting method, the Company recorded the costs associated with those purchases, *i.e.*, the amounts paid to the wholesale suppliers plus the approved administrative charges and the GRT. Thus, PPL recorded an entire month of costs in January 2010.

However, revenues in January 2010 were handled differently. PPL recorded only about 15 days of *billed* revenues rather than 30 days of *earned* revenues. Because PPL's billing cycle does not follow a calendar month, roughly half of the revenues billed in January 2010 were for electricity supplied in December 2009. The January 2010 revenues associated with December 2009 consumption were "pro-rated" to December 2009. Thus, only approximately 15 days of revenue billed in January were for January consumption.³² The other 15 days of January consumption were subsequently billed in February. Although PPL *earned* an entire month of revenue in January, only 15 days of *billed* revenue were recorded for reconciliation purposes in January. By the end of February 2010, PPL had incurred costs for two full months; it had billed

³² For the purposes of simplicity, the OSBA is adopting PPL witness Joseph M. Kleha's "rule of thumb" that approximately 15 days of revenue billed in January was for December 2009 consumption. *See* Hearing Transcript at 27, lines 19-25.

for all of the January service, but had only billed for approximately half of February. This pattern continued throughout 2010.

At the end of 2010, however, PPL did not pro-rate January 2011 billings to December 2010 in the same manner as it pro-rated January 2010 billings to December 2009.³³ Therefore, at the end of 2010, PPL reported 12 months of costs and 11½ months of *billed* revenues, rather than 12 months of *earned* revenues.³⁴ This resulted in a substantial reported 2010 “undercollection.”

The OSBA’s argument is that PPL’s reconciliation accounting method results in a reported undercollection that is not really an undercollection at all, in that PPL billed for all of its 2010 costs by the first billing period in January 2011. By billing through the reconciliation process for a reported undercollection that does not really exist, PPL is receiving a financing benefit by way of a pre-payment from ratepayers.³⁵ Such a financing benefit was not anticipated when the Company’s CBP was approved by the Commission and was not claimed when PPL established the 2010 GSC.³⁶ Therefore, this pre-payment is being imposed retrospectively.

B. Proration is Inconsistent With Matching Principle

It is a fundamental principle of accounting to match revenues and costs.³⁷ To match revenues and costs properly, PPL must reconcile 12 months of costs with the 12 months of *earned* revenues based on those costs. This could have been accomplished in PPL’s year-end 2010 reconciliation simply by making an adjustment to reflect the fact that approximately half of the revenues billed in January 2011 were for electricity supplied in December 2010. PPL’s year-

³³ OSBA Statement No. 1 at 10.

³⁴ *Id.* at 8-9.

³⁵ *Id.* at 11.

³⁶ *Id.* at 10.

³⁷ *Id.* at 8.

end reconciliation report would, then, have matched 12 months of costs to 12 months of *earned* revenue, instead of only approximately 11½ months of *billed* revenue.

PPL witness Joseph Kleha's assertion that the Company's reconciliation accounting method "properly matches the actual *billed* revenue for utility service provided in a given month with the actual *incurred* costs to provide such service in the same month" is not matching at all.³⁸

As OSBA witness Mr. Knecht explained in his Surrebuttal Testimony:

Mr. Kleha's reference to matching 'billed revenue for service provided in a given month' with 'actual incurred costs to provide *such service*' is incorrect. Saying that *billed* revenues are properly matched to *incurred* costs is akin to saying that oranges are properly matched to apples. Billed revenues for a particular month reflect the utility service provided partly in the prior month and partly in the current month. Costs incurred for a particular month reflect the costs incurred for providing service only in the current month. PPL Electric's method simply does not match revenues for the service with the specific costs for providing 'such service.' It incorrectly matches revenues for one period with costs for a different (albeit partly overlapping) period.³⁹

Matching 12 months of incurred costs with the same 12 months of earned revenue would result in a significantly lower "undercollection" to be recouped from *SC&I* ratepayers through the June GSC-1.

C. March 8, 2010 Letter

The issues and concerns raised by the OSBA with respect to PPL's accounting method are not new to PPL. In fact, PPL itself recognized in the March 8, 2010, letter that the 2010 reported undercollection was "not representative of a true over/undercollection."⁴⁰ The letter

³⁸ PPL Statement No. 1-R at 5 (emphasis added).

³⁹ OSBA Statement No. 2 at 6.

⁴⁰ Exhibit IEC-2, attached to OSBA Statement No. 1.

gave several reasons for this conclusion. The first acknowledged that “the reconciliation process reflects only experienced revenues and expenses.”⁴¹ PPL explained that:

Because many customer bills issued in January 2010 were prorated for usage which occurred in 2009, or prior to implementation of the GSC, billed revenue under the GSC for January 2010 reflects only about half of the revenue that typically would be derived from a full, non-prorated billing month. However, generation supply-related costs incurred for January 2010 reflect a full month of customer electricity usage. This difference between prorated billed revenue and actual incurred costs creates a significant undercollection for the month of January 2010.⁴²

Consistent with its conclusion that the reported undercollection was not a “true” undercollection, PPL anticipated that the billing lag in January 2010 would resolve itself by the end of 2010 as a result of a similar adjustment to be made for January 2011. Specifically, the Company stated:

Although proration of bills can always create some over/undercollections, *a full year’s reconciliation of revenue and costs will generally balance out, because the proration effects are reflected in the first and last months of each annual reconciliation.*⁴³

Based on its March 8, 2010, letter, PPL appears to have intended to reflect in its year-end reconciliation that half of the revenues earned or accrued in December 2010 would be billed in January 2011. This intention is further evidenced in PPL’s request to “defer the 2010 proration undercollection and reflect that amount in GSC rates to become effective January 2011.”⁴⁴ The only rationale for deferring the January 2010 proration undercollection until January 2011 would have been to adjust for revenue billed in the first half of January 2011 for consumption at the end

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* (emphasis added).

⁴⁴ *Id.*

of December 2010, thus balancing out the proration undercollection and eliminating part of the reported undercollection PPL recovered through the June GSC-1.

Unfortunately, PPL did not pro-rate its January 2011 revenue as it had in January 2010.

As Mr. Knecht explained in his Direct Testimony:

[T]he Company's response to OSBA-II-1(e) claims that the Company did apply a similar pro-rating to January 2011 bills. However, PPL Electric's records do not show the effects of any such pro-rating in the 2010 GSC reconciliation. Had the Company actually applied a similar pro-rating for January 2011 billings, it would have moved a substantial portion of January billed revenues into December of 2010, thereby reducing the year-end 2010 undercollection. In contrast, while the Company's monthly revenue and sales reports for January 2010 show the effects of the shift in billed revenues, the revenue and sales records for December 2010 and January 2011 do not.⁴⁵

PPL's failure to pro-rate January 2011 bills, as it did January 2010 bills, prevented the balancing out of the reported undercollection related to the mismatch between billed revenues and incurred costs. This failure contributed significantly to the 4.15 cents per kWh reconciliation charge on SC&I customers and the 31% increase in their generation rates for the June-August 2011 quarter. But for reconciliation charges, the GSC-1 would have decreased on January 1, 2011, and again on June 1, 2011, because procurement costs were declining.⁴⁶

D. No Reasonable Justification for Proration

PPL does not dispute that its reconciliation accounting method caused a significant reported undercollection. Although using this proration method results in a mismatch of revenues and costs, a false reported undercollection, and unreasonable rates, PPL has offered no

⁴⁵ OSBA Statement No. 1 at 10.

⁴⁶ *Id.* at 6-7 (GSC-1 for January 1, 2011, through May 31, 2011, would have been 8.293 cents per kWh without reconciliation charge); OSBA Statement No. 2 at 2 (June GSC-1 would have been 8.02 cents per kWh without reconciliation charge). The 2010 GSC was 10.125 cents per kWh and did not include a reconciliation charge.

justification other than “that is how it’s always been done.” For example, in his rebuttal testimony, PPL witness Mr. Kleha claimed that Mr. Knecht’s assertions with respect to PPL’s reconciliation accounting method “completely ignore long-standing practice and precedent regarding the reconciliation mechanics of Section 1307(e) cost recovery mechanisms for PPL Electric and other utilities in this jurisdiction.”⁴⁷

Mr. Kleha’s entrenched reliance on precedent is misguided for several reasons. First, PPL itself did not strictly adhere to precedent. In its March 8, 2010, letter, PPL recognized that its accounting method, combined with the Commission’s CBP decision regarding GSC reconciliation, would result in unreasonable rates. In that letter, PPL proposed an alternative to Commission precedent in order to avoid setting unreasonable rates. Unfortunately, PPL failed to follow through fully on that proposed departure from precedent. That failure led to the flawed June GSC-1.

Second, as Mr. Knecht stated in his Surrebuttal Testimony, “It is wrong to slavishly adhere to Commission precedent when such precedent results in unjust and unreasonable rates.”⁴⁸ PPL relies almost exclusively on past Commission practice to justify a reconciliation method which has undermined one of the key goals of its default service plan, *i.e.*, stable default service rates. Both the CBP and the DSP provide for the majority of electric supplies to be purchased through full-requirements, load-following contracts.⁴⁹ The advantage of these contracts is that supplies are purchased at a fixed per-kWh price, thus reducing the risk ratepayers would face from market price swings and resulting in reasonably stable default

⁴⁷ PPL Statement No. 1-R at 2.

⁴⁸ OSBA Statement No. 2 at 4.

⁴⁹ OSBA Statement No. 1 at 3-4.

service rates. Because the risk of market volatility is passed onto the full-requirements suppliers, a risk premium is built into the default service price. However, despite paying a risk premium for stable rates, SC&I customers on default service got exactly the opposite.⁵⁰

PPL's reconciliation method also undermines yet another aim of its default service plan, *i.e.*, to provide a reliable price signal for competition. With reconciliation charges moving the GSC up and down without any relation to costs or to market prices, the Price To Compare is substantially distorted. PPL has acknowledged that distortion.⁵¹

E. Commission Precedent Is Distinguishable

If adherence to Commission precedent results in rates that are not just and reasonable, the precedent should be overturned. However, it is not necessary to overturn Commission precedent in this proceeding because such precedent can be readily distinguished.

In his Surrebuttal Testimony, Mr. Knecht articulated four reasons why Commission precedent regarding reconciliation of other costs and revenues is not appropriate in this case.⁵²

Specifically, he stated:

First, as I mentioned earlier, an integral aspect of the design of PPL Electric's default service plans was to provide stable rates to default service customers. It is not clear that previous reconciliation mechanisms applied to circumstances in which stable rates were crucial.

Second, it is not clear that the earlier reconciliation mechanisms involved costs that represented such a large share of the overall customer bill. As it relates to this case, the 2010 generation supply charge represents over 75 percent of the average Rate GS-1 customer bill and over 82 percent of the average Rate GS-3 customer bill. Instability in the GSC will therefore necessarily create instability in total electric bills. Avoiding rate instability

⁵⁰ OSBA Statement No. 2 at 4.

⁵¹ PPL Statement No. 1-R at 3.

⁵² OSBA Statement No. 2 at 4-5.

should therefore be an important feature of the GSC reconciliation mechanism.

Third, it is not clear that the earlier reconciliation mechanisms were intended to be part of a price-to-compare for retail competition, as is the case with the GSC. To establish reasonable price signals, it is important that the price-to-compare not include significant charges or credits related to prior period under- or over-recoveries. However, as shown in Figure IEc-2 above, the Company's method results in huge reconciliation charges.

Fourth, it is not clear that the earlier reconciliation mechanisms were implemented at a time when customers were already facing a substantial rate increase, as was the case for the GSC. The GSC was implemented at a time when PPL Electric was transitioning from capped to market-based generation rates at the beginning of 2010. Under the conditions where customers are already facing large increases, rate stability becomes a more important rate design attribute.⁵³

For all of these reasons, Commission precedent regarding Section 1307(e) cost recovery mechanisms should not apply to the GSC reconciliation.

F. PPL Is Not Required to Use Proration

PPL has also argued that it does not have the authority to use any method other than the proration accounting method because of its tariff and the Commission Order approving its CBP and its DSP. However, nowhere do PPL's tariff, the CBP Order, or the DSP Order even mention the reconciliation accounting method that must be used. Furthermore, at the hearing on October 5, 2011, PPL witness Mr. Kleha was unable to point to any place in PPL's tariff, or the CBP Order (which governs the 2010 GSC) at which PPL was directed to use the proration accounting method.⁵⁴

⁵³ *Id.* at 5 (footnotes omitted).

⁵⁴ Hearing Transcript at 47, lines 22-23.

In fact, PPL's accounting method actually appears to be inconsistent with the express language of the CBP Order. The CBP Order states, in pertinent part:

Additionally, it is important to match current POLR costs with current POLR revenues. This matching concept will also ensure the timely collection or refund of any imbalances and will minimize the potential for future customers POLR to be subsidized by current POLR customers.⁵⁵

In the CBP Order, the Commission acknowledged the fundamental principle of matching costs and revenues. In each of PPL's reconciliation calculations, the Company includes current costs for all kWh purchased, but only includes revenues for kWh billed. Excluding unbilled revenues does not reflect all current earned revenues. Because the billed revenues will never match the current costs, PPL's accounting method results in a mismatch between revenues and costs and is, therefore, inconsistent with the CBP Order.

Moreover, the Commission's intent in the CBP Order was to avoid having current default service customers subsidize future default service customers. Ironically, the opposite has happened here. Due in large part to PPL's proration accounting method, current default service customers are subsidizing past default service customers by paying a significant reconciliation charge for a reported undercollection arising from costs incurred in 2010.

PPL's accounting method is also arguably inconsistent with the reconciliation provisions in its tariff. Both the GSC and GSC-1 riders state in pertinent part, "The reconciliation will be the difference between GSC revenue produced by actual usage and GSC revenue estimated on the basis of projected usage for that previous application period."⁵⁶ This language at least

⁵⁵ OSBA Exhibit B at 54.

⁵⁶ OSBA Exhibit D, Generation Supply Charge Rider, Tariff Electric – Pa. P.U.C. No. 201 at 19Z.3; OSBA Exhibit E, Generation Supply Charge-1 Rider, Tariff Electric – Pa. P.U.C. No. 201 at 19Z.5D.

suggests that revenue should be based on the kWhs actually consumed during the period and not on the kWhs billed during that period.

At a minimum, the CBP Order and PPL's tariff did not require PPL to use this proration accounting method to reconcile the 2010 GSC. PPL has the authority to use a different accounting method that is actually more consistent with the CBP Order and the language in the Company's tariff.

G. Shopping Does Not Increase Accounting Undercollection

PPL witness Mr. Kleha attempted to explain the magnitude of the 2010 reported undercollection as being a function of increased customer shopping.⁵⁷ As ALJ Colwell correctly observed at the hearing, "I understand why shopping is going to result in higher prices for those who don't shop because of the undercollection. I don't understand why that would cause more of an undercollection."⁵⁸ This was an astute observation because shopping will not increase the magnitude of the undercollection. It will only cause there to be fewer default service customers left to pay for it through the reconciliation process.

Mr. Knecht's unrebutted example in his Direct Testimony demonstrates how increases in shopping should actually *reduce* the dollar value of the undercollection created by the accounting mismatch.⁵⁹ Under the Company's reconciliation accounting method, the undercollection each month should only reflect the unbilled revenues from the prior month. Therefore, if shopping increases and default service load declines, the dollar value of the undercollection should decline.⁶⁰

⁵⁷ PPL Statement No. 1-R at 9.

⁵⁸ Hearing Transcript at 36, lines 8-11.

⁵⁹ OSBA Statement No. 1 at 12-14.

⁶⁰ *Id.*

H. Working Capital Is After-the-Fact Justification

In his Rebuttal Testimony, PPL witness Mr. Kleha attempted to justify PPL's proration method by pointing out that PPL does not receive any working capital allowance in its distribution rates for any of its Section 1307(e) cost recovery mechanisms, including the GSC and GSC-1. He claimed that the proration accounting method provides the required working capital allowance.⁶¹ The OSBA does not dispute that Section 69.1808(a)(4) of the Commission's default service policy statement provides that the Price To Compare should include all costs related to default service, including working capital.⁶²

However, PPL made no claim for working capital in its CBP case or in its DSP case. PPL also made no specific request to recover working capital costs by using proration for its GSC and GSC-1 reconciliation. If PPL anticipated using its proration accounting method to create an "undercollection" as a source of funds for working capital, the Company should have sought authorization from the Commission to do so. The first mention of working capital should not be in an after-the-fact reconciliation proceeding where there exists no line item for working capital costs in PPL's reconciliation calculation filed with the Commission.

With adequate notice in the CBP proceeding or in the DSP proceeding, parties could have objected to charging ratepayers for working capital costs through this flawed reconciliation method and could have proposed alternatives. One such alternative would have been for PPL to forecast the working capital rate base and associated capital costs of providing default supply. As Mr. Knecht explained in his Surrebuttal Testimony, such an "approach would result in default service ratepayers providing a return on working capital rate base, rather than requiring default

⁶¹ PPL Statement No. 1-R at 9-10.

⁶² 52 Pa. Code § 69.1808(a)(4).

service ratepayers to pre-fund the rate base itself (as is the case with the GSC reconciliation mechanism).”⁶³

⁶³ OSBA Statement No. 2 at 9, fn. 7.

VI. Under-Reporting of Revenues

Regardless of the Commission's determination on the accounting issue, proration does not explain a significant portion of the reported 2010 undercollection. A targeted audit by the Bureau of Audits is necessary to justify the significant variance between PPL's reported revenues and the rates it charged pursuant to its tariff.⁶⁴

OSBA witness Mr. Knecht testified that a large portion of that undercollection cannot be attributed to PPL's accounting method because the exclusion of unbilled revenues in the Company's reconciliation calculation would not result in an undercollection of this magnitude. As described above, Mr. Knecht's testimony demonstrated how as shopping increases and default service load declines, the dollar value of the undercollection should decline.⁶⁵ The fact that the SC&I GSC undercollection declined only modestly during 2010 despite rapid growth in SC&I shopping strongly suggests that PPL's undercollection was due to factors beyond the reconciliation accounting mismatch.

PPL's reported year-end 2010 SC&I undercollection is \$29.2 million. PPL reported December 2010 unbilled revenues to be \$14.8 million.⁶⁶ In other words, \$14.8 million of the total \$29.2 million reported undercollection is the result of the Company's accounting method. That means the remaining \$14.4 million of the total 2010 undercollection resulted from causes other than the accounting method.⁶⁷

⁶⁴ OSBA Statement No. 1 at 21.

⁶⁵ *Id.* at 12-14.

⁶⁶ PPL response to OSBA-II-1(f), attached to OSBA Statement No. 1. Mr. Knecht estimated December 2010 unbilled revenues to be \$11.8 million based on the percentage of January 2010 revenue which PPL assigned to December 2009. OSBA Statement No. 1 at 16.

⁶⁷ OSBA Statement No. 1 at 17.

Mr. Knecht reviewed the Company's reported revenues and concluded that a substantial portion of the 2010 undercollection that is not related to PPL's accounting method can be explained by an under-reporting of revenues. Mr Knecht's conclusions were based on the following observations. Although the GSC rate was the same each month in 2010, the reported per-kWh revenues billed varied materially from month to month.⁶⁸ Specifically, the GSC rate each month was 10.125 cents per kWh, but the average revenue reported by PPL for 2010 was only 9.707 cents per kWh.⁶⁹ This means that the revenues reported are not consistent with the rates PPL was required to charge and presumably did charge. There is a 0.418 cent per kWh variance between the tariff rate charged and the average revenue reported. Such a variance would account for an undercollection of about \$14.3 million, which is very close to the \$14.4 million shortfall described above that cannot be explained by PPL's accounting method. Mr. Knecht thus concluded that the portion of the reported 2010 undercollection that is not related to PPL's accounting method appears to be related to an under-reporting of revenues.⁷⁰

If the Company charged the tariff rate, then the revenue it actually billed exceeded what PPL reported. Consequently, a portion of the reconciliation charge is a double billing.

In his rebuttal testimony, PPL witness David R. Woodruff put forth various theories to explain the discrepancies in revenue that Mr. Knecht uncovered. However, none of these explanations justified the difference in reported revenues and tariff charges.

Mr. Woodruff suggested that the discrepancies between tariff rates and reported revenues may have been caused by the costs of company-use power that were included in the default

⁶⁸ OSBA Statement No. 1 at 21, Table IEc-2.

⁶⁹ OSBA Statement No. 1 at 21.

⁷⁰ *Id.* at 20.

service charge in 2010.⁷¹ There are at least three problems with this purported explanation. First, because Mr. Woodruff's testimony provided no evidence of the magnitude of company-use power, its potential impact is unknown and cannot be evaluated. Second, Mr. Woodruff's hypothesis does not explain why the difference between revenues and tariff charges in January 2010 was so much greater than for any other month. Third, this hypothesis does not explain why the SC&I class experienced significant variances between revenues and tariff charges in February through December while the residential class did not.⁷²

Mr. Woodruff also offered a second hypothesis to explain the discrepancies in revenues. Specifically, he suggested that the discrepancies may be due to the requirement that PPL make estimates regarding revenue and costs.⁷³ But, again, this does not explain the variances between PPL's reported revenues and the tariff charges. As Mr. Knecht explained in his Surrebuttal Testimony, errors related to estimates should work themselves out over time because at some point, estimates must be replaced by actual revenues and actual costs.⁷⁴ If the problem were in estimating, it would have been corrected by the end of 2010 because actual numbers had replaced any off-target estimates.⁷⁵ However, PPL consistently reported revenues below tariff charges for SC&I customers in 2010, even after the Company had both actual revenues and actual costs.

The OSBA is not requesting that the Commission make a determination at this time that PPL has under-reported revenues. Under-reporting is Mr. Knecht's conclusion based on the

⁷¹ PPL Statement No. 2-R at 7.

⁷² OSBA Statement No. 2 at 9.

⁷³ PPL Statement No. 2-R at 8.

⁷⁴ OSBA Statement No. 2 at 10.

⁷⁵ *Id.*

limited information available to him within the constraints of discovery in this proceeding. Furthermore, Mr. Woodruff has attempted to explain the shortfall differently. Therefore, the only way to determine definitively what factors contributed to that part of the undercollection unrelated to PPL's reconciliation accounting method, is a full and detailed audit of the Company's revenue and cost accounts by the Bureau of Audits. At the time rebuttal testimony was filed and at the time of the hearing, PPL indicated that an audit was ongoing. However, PPL was unable to state whether the auditors were focusing on what Mr. Knecht described as under-reporting.⁷⁶ Therefore, the OSBA respectfully requests that the Commission direct its Bureau of Audits to conduct a detailed audit of the Company's default service revenue and cost records for 2010 to evaluate the inconsistencies and anomalies in the Company's records identified by Mr. Knecht in his testimony. If the audit shows that PPL has in fact under-reported 2010 revenues and thus overcollected through GSC-1 reconciliation charges in 2011, the OSBA respectfully requests that the Commission order PPL to make appropriate refunds to default service customers.

⁷⁶ OSBA Exhibit A; Hearing Transcript at 49-50.

VII. Competitive Transition Rider and Reconciliation Rider Are Not a Solution

PPL has proposed a Competitive Transition Rider and Reconciliation Rider related to transmission service and generation supply service. The Reconciliation Rider would refund overcollections to, and recover undercollections from, customers who were default service customers when the overcollection or undercollection occurred. The Competitive Transition Rider would refund, or recover, the balance of historic overcollections or undercollections in existence on the effective date of the Reconciliation Rider.⁷⁷

These riders do not offer an explanation or a solution to the issues the OSBA has raised with regard to PPL's proration accounting method and the Company's apparent under-reporting of revenues. The riders present an alternative mechanism through which any overcollection or undercollection could be recovered or refunded. However, the issue in this proceeding is the true amount of any undercollection for 2010, not the method by which it should be recovered.

Despite the Company's having submitted extensive testimony in this proceeding regarding the proposed Competitive Transition Rider and Reconciliation Rider, counsel for PPL apparently agreed with the OSBA when he stated at the hearing that "[t]his proceeding deals with what the proper amount of under and overcollections to be reflected in the GSC-1 rate are to be. The other proceeding [PPL petition for authorization to implement the Reconciliation Rider and Competitive Transition Rider] deals with how those over undercollections are going to be collected from customers."⁷⁸ Therefore, the proposed riders are irrelevant to this proceeding.

⁷⁷ PPL Statement No. 1-R at 12-14; Petition of PPL Electric Utilities Corporation to Implement a Reconciliation Rider, Docket No. P-2011-2256365, filed August 25, 2011.

⁷⁸ Hearing Transcript at 64, lines 1-4.

VIII. Conclusion

For the reasons set forth above, the OSBA respectfully requests that the ALJ and the Commission:

- (1) find that PPL's proration accounting method resulted in June GSC-1 rates that were not just and reasonable;
- (2) direct the Bureau of Audits to conduct a detailed audit of the Company's default service revenues and costs for 2010, including the possible under-reporting of revenues; and
- (3) direct PPL to make refunds as appropriate to default service customers.

Respectfully submitted,



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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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| William R. Lloyd, Jr., Small Business Advocate | : | DOCKET NO. C-2011-2245906 |
| v. | : | |
| PPL Electric Utilities Corporation | : | |
| PPL Electric Utilities Corporation | : | |
| Calculation of Generation Supply Charge-1 | : | DOCKET NO. M-2011-2243137 |

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Main Brief, 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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