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October 26, 2011

Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
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**RE: William R. Lloyd, Jr., Small Business Advocate v. PPL Electric Utilities Corporation
Docket No. C-2011-2245906**

**PPL Electric Utilities Corporation Proposed Generation Supply Charge-1 for the period June 1, 2011 through August 31, 2011
Docket No. M-2011-2243137**

Dear Secretary Chiavetta:

Enclosed please find the Main Brief of PPL Electric Utilities Corporation in the above-referenced proceeding. Copies will be provided as indicated on the certificate of service.

Respectfully Submitted,



Anthony D. Kanagy

ADK/skr
Enclosure

cc: Honorable Susan D. Colwell
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been served upon the following persons, in the manner indicated, in accordance with the requirements of § 1.54 (relating to service by a participant).

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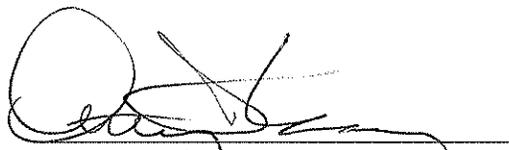
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

William R. Lloyd, Jr.	:	
Small Business Advocate,	:	
Complainant	:	
	:	
v.	:	Docket No. C-2011-2245906
	:	M-2011-2243137
PPL Electric Utilities Corporation,	:	
Respondent	:	

**MAIN BRIEF OF
PPL ELECTRIC UTILITIES CORPORATION**

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I. INTRODUCTION

On May 20, 2011, PPL Electric Utilities Corporation (“PPL Electric” or the “Company”) filed its Generation Supply Charge-1 (“GSC-1”) for the period June 1, 2011 through August 31, 2011 (“Application Period”) with the Pennsylvania Public Utility Commission (“Commission”). The default service rates were set based upon a projection of the Company’s default service costs for the Application Period and also were designed refund or to recover prior period over/undercollections from each customer class.

On May 31, 2011, the Office of Small Business Advocate (“OSBA”) filed a complaint against the May 20 GSC-1 filing and, in particular, the rate increase for small C&I customers. The gravamen of the complaint involves the amount of the undercollection for 2010. See OSBA Complaint, ¶ 8; OSBA St. 1, p. 2.

The facts in this proceeding generally are not in dispute. It is undisputed that PPL Electric is following the reconciliation methodology that it has followed for each of its Section 1307(e) cost recovery mechanisms for over 30 years. It is undisputed that PPL Electric’s reconciliation methodology is consistent with long-standing Commission practice and precedent. It is undisputed that PPL Electric’s reconciliation methodology is consistent with the requirements of Section 1307(e) of the Public Utility Code and how the Commission’s Bureau of Audits reviews and audits the Company’s GSC-1. It also is undisputed that PPL Electric has a statutory right to recover all of the costs it incurs to procure default service supply, and it is further undisputed that default service costs include a form of cash working capital allowance. The reconciliation methodology employed by PPL Electric provides this form of cash working capital allowance, and it is a necessary and appropriate part of the total cost of providing default supply to customers.

Despite these undisputed facts, the OSBA contends that PPL Electric and the Commission should abandon over 30 years of precedent and practice to address a one-time problem that, as anticipated, now has largely been resolved. The undercollection amount for small C&I customers has been reduced from approximately \$22.4 million as of April 30, 2011 to approximately \$1.4 million as of August 31, 2011. The significant undercollection related to proration is not likely to happen again for the GSC-1 because reconciliation balances of this magnitude generally arise only at the beginning of a new Section 1307(e) cost recovery mechanism. The undercollection/proration issue has been resolved under the normal operation of the GSC-1 reconciliation, and PPL Electric does not believe that it is appropriate to overturn 30 years of practice and procedure to remedy a problem that no longer exists, that was caused in large part because of a change in the term of the reconciliation period and is not likely to recur in the future.

In addition, the unprecedented alternatives proposed by OSBA, i.e., impute unbilled revenues or remove actual expenses: (1) are clearly inconsistent with the reconciliation requirements of Section 1307(e) and would complicate auditing of the GSC-1 by the Commission; (2) would deny PPL Electric any cash working capital allowance for its default service expenses and thereby deny it full and current cost recovery as required by Act 129; (3) are unnecessary because the undercollection already has been largely recovered from customers; and (4) would not stabilize rates because they do not address the root cause of the undercollection, i.e., quarterly vs. annual reconciliation of the GSC-1 and lack of a Reconciliation Rider.

Based upon the undisputed facts in this proceeding, the OSBA's complaint against PPL Electric's GSC-1 should be dismissed.

II. BACKGROUND AND PROCEDURAL HISTORY

PPL Electric provides electric distribution, transmission and default generation services to approximately 1.4 million customers in a certificated service territory that spans approximately 10,000 square miles in all or portions of 29 counties in eastern and central Pennsylvania. PPL Electric is a “public utility” and “electric distribution company” (“EDC”) as those terms are defined under the Public Utility Code, 66 Pa. Code §§ 102 and 2803.

On August 2, 2006, PPL Electric filed a Petition for Approval of a Competitive Bridge Plan (“CBP”) with the Commission. Under the CBP, the Company requested Commission approval of a plan to acquire default supply for customers in 2010, as a bridge between the expiration of the Company’s generation rate cap on December 31, 2009, and the expiration of several other EDCs’ generation rate caps on December 31, 2010. In the CBP proceeding, the Company proposed to recover its default service costs through a reconcilable Section 1307(e) cost recovery mechanism, with reconciliation to be performed on an annual basis. The Commission approved the Company’s CBP proposal, with certain modifications, by Order entered May 17, 2007. *See Petition of PPL Electric Utilities Corporation for Approval of a Competitive Bridge Plan*, Docket No. P-00062227, Order entered May 17, 2007 (“CBP Order”). One of the modifications, which in large part ultimately led to the current complaint proceeding, was to require PPL Electric to implement quarterly, as opposed to annual, reconciliation. See CBP Order, p. 54.

On August 28, 2008, PPL Electric filed a Petition requesting Commission approval of the Company’s plans to procure default supplies for customers for the period of January 1, 2011 through May 31, 2014 (“POLR II Proceeding”). This period subsequently was modified to end on May 31, 2013. In the POLR II Proceeding, the Company reached a settlement of all but two issues with the other parties. *See Petition of PPL Electric Utilities Corporation for Approval of*

a Default Service Program and Procurement Plan for the Period January 1, 2011 Through May 31, 2013, Docket No. P-2008-2060309. The Commission approved the POLR II Settlement by Order entered June 30, 2009. The POLR II Settlement provided for PPL Electric to recover its default service costs for residential and small C&I customers through the GSC-1.

PPL Electric began providing service to default service customers under its CBP in January 2010. Bills that were sent out in January 2010 included service for both part of December 2009 and part of January 2010. Therefore, when PPL Electric prepared its GSC reconciliation calculation for the period January 2010 through December 2010, PPL Electric excluded from the calculation those revenues associated with service that was provided in December 2009.¹ However, the reconciliation calculation included a full 12 months of costs incurred in January 2010. This created an undercollection for 2010 because PPL Electric did not otherwise recover sufficient revenues for service provided in 2010 to meet its costs.

On December 1, 2010, PPL Electric filed its proposed calculation of the GSC-1 rates for the application period January 1, 2011 through May 31, 2011. On December 14, 2010, PPL Electric filed its final calculation of the GSC-1 rates for the application period January 1, 2011 through May 31, 2011. Both of these filings included, as the “E” Factor component, the net GSC over or under collection balance for the residential and small C&I customer classes as of November 30, 2010. On December 16, 2010, the Commission issued a Secretarial Letter at Docket No. M-2010-2213310, approving PPL Electric’s GSC-1 rates to become effective on January 1, 2011.

On February 8, 2011, a Section 1307(e) reconciliation hearing was held regarding PPL Electric’s 2010 GSC over or under collection balances for the residential, small C&I, and large

¹ This procedure is known as proration. This procedure is consistent with long-standing Commission practice and precedent and the Company was required to prorate revenues in order to avoid violating the generation rate caps.

C&I customer classes at Docket No. M-2010-2213731. In a Recommended Decision issued on February 28, 2011, Your Honor recommended acceptance of the Company's reconciliation of the 2010 GSC because it was not disputed. In its Order entered on April 14, 2011, the Commission adopted as its own action the Recommended Decision.

On May 20, 2011, PPL Electric filed its GSC-1 for the June 1, 2011 through August 31, 2011 Application Period. The GSC-1 rates were set based upon a projection of costs for the Application Period and also included prior period undercollections, including the undercollection experienced by the Company in 2010 that had not been fully recovered at that date.

On May 31, 2011, the OSBA filed a Complaint against the May 20 GSC-1 filing. On June 22, 2011, the Office of Trial Staff ("OTS"), now the Bureau of Investigation and Enforcement ("I&E"), filed a Notice of Appearance. PPL Electric filed an Answer to OSBA's Complaint on June 29, 2011. On July 12, 2011, the Office of Consumer Advocate ("OCA") filed a Notice of Intervention and Public Statement.

PPL Electric, OSBA and OTS filed prehearing memoranda. A prehearing conference was held on July 13, 2011. At the prehearing conference, the parties agreed to a litigation schedule and modified discovery terms which were set forth in the Scheduling Order issued by Administrative Law Judge Susan D. Colwell (the "ALJ") on July 13, 2011.

On July 29, 2011, PPL Electric and OSBA served Direct Testimony. On August 15, 2011, PPL Electric served Rebuttal Testimony. On August 25, 2011, OSBA served Surrebuttal Testimony. On September 30, 2011, PPL Electric served written Rejoinder Testimony.

The initial hearing in this proceeding originally was scheduled for August 29, 2011. This hearing date was canceled, and the hearing was re-scheduled for October 5, 2011. At the hearing, the parties moved their pre-filed testimony and exhibits into the record. In addition, the parties' witnesses responded to questions posed by the ALJ, as well as follow-up questions by

counsel. At the hearing, the parties also agreed to submit Main Briefs on October 26, 2011 and Reply Briefs on November 9, 2011.

Pursuant to the schedule adopted at the hearing, PPL Electric hereby submits its Main Brief in this proceeding. In addition, pursuant to 52 Pa. Code § 5.501, Proposed Findings of Fact, Conclusions of Law and Ordering Paragraphs are provided in Appendix A hereto.

III. SUMMARY OF ARGUMENT

OSBA's principal contention is that PPL Electric's method for reconciling its GSC-1 rate "makes no sense," because it reconciles 12 months of expense with 11 ½ months of revenue. OSBA is wrong for several reasons. First, it is undisputed that PPL Electric's reconciliation method is identical to the method it and other electric utilities have employed to reconcile Section 1307 rates for more than 30 years. Second, it is undisputed that PPL Electric's method is consistent with long-standing Commission precedent regarding prorating the effect of rate changes and the exclusion of unbilled revenues in determining rates. Third, the OSBA's argument fails to recognize that cost recovery under a Section 1307 cost recovery mechanism is a two-year process involving both a projected cost recovery and a reconciliation mechanism. It is undisputed that over the applicable two-year period, PPL Electric's method will reconcile 24 months of expense and 24 months of revenue. Fourth, by excluding unbilled revenue from its reconciliation methodology, PPL Electric has complied with the plain language of Section 1307(e), which specifies that reconciliation filings must be based on "revenues received," which obviously does not include revenues that have not yet been billed. This approach also provides actual data that can be meaningfully audited by the Commission. Fifth, it is undisputed that PPL Electric's reconciliation method provides a form of working capital allowance to reflect the lag between payment of default service expense and the recovery of default service revenue from customers. A provision for working capital is consistent with long-standing Commission and judicial precedent and, in fact, the Commission has specifically recognized in its Default Service Policy Statement that cash working capital is a proper component of default service costs. Act 129 specifically states that EDCs are entitled to full and current recovery of their default costs. Without the cash working capital allowance provided by its reconciliation methodology, PPL Electric would not fully recover its cost of providing default service. For these reasons, PPL

Electric's method for reconciling default costs is reasonable and should continue to be used as it has been for over 30 years.

OSBA does not dispute that PPL Electric's method is consistent with long-standing practice and that it provides a working capital allowance, but argues that it should not be utilized for default service rates because it will produce a substantial first-year under collection and a subsequent distortion of default service rates in year two. This argument should be rejected for several reasons. First, OSBA significantly overstates the goal of rate stability, which is not one of the principal goals of Act 129 or electric restructuring. Second, the substantial rate distortion cited by OSBA primarily is caused by quarterly (instead of annual) reconciliation and not by PPL Electric's method of reconciliation. If annual reconciliation had been in effect here, as proposed by PPL Electric, but rejected by the Commission, the level of rate variation would have been very substantially reduced and very likely would not have been an issue. As explained on page 22 below, PPL Electric estimates that if annual reconciliation had been in place, default service rates would have increased 3.2% on January 1, 2011, decreased by 2.6% on June 1, 2011 and decreased by 7.9% on September 1, 2011. Third, the "problem" identified by OSBA is a one-year problem, at most, and is now largely over. The undercollection for 2010 has been recovered almost in full and should not be an issue going forward. OSBA's proposes a "solution in search of a problem" that need not be adopted in this proceeding. Fourth, if OSBA's proposal were adopted, it would require a substantial refund to small C&I customers which would create a very large overcollection credit in next year's GSC-1 rate. This would result in a temporary downward distortion in default service rates, send a false price signal to customers to return to default service, and thereby fundamentally disrupt retail competitive markets. Fifth, to the extent that POLR rate variations may be of concern in the future for other reasons, the solution is to adopt annual reconciliation, as initially proposed by the Company, and to implement a

reconciliation rider, as proposed by PPL Electric in a currently pending proceeding and as widely adopted by the natural gas industry.

OSBA's primary proposals in this proceeding are to include unbilled revenues or exclude actual expenses from the reconciliation methodology. These proposals are facially inconsistent with the plain language of Section 1307(e), which specifically requires that reconciliation be based upon "actual expenses" and "revenues received." As explained above, OSBA's proposals also are fundamentally inconsistent with Commission precedent, would cause serious problems in auditing PPL Electric's GSC-1 rates, would deny PPL Electric a working capital allowance and prevent full and current cost recovery as required by Act 129. They also are completely unnecessary and would cause a further future distortion of default service rates.

However, if the ALJ or Commission were to consider adopting OSBA's proposal, several important conditions should be imposed: (1) any change should be implemented prospectively only; (2) any change should be considered and reviewed as part of the Commission's current rulemakings addressing improvements to competitive markets and be applicable to all EDCs; (3) any change should provide information that can be meaningfully audited by the Commission; and (4) any change must include a substitute method to allow for recovery of PPL Electric's working capital requirement for default service costs.

Finally, OSBA also presented an extensive discussion of other issues regarding PPL Electric's reporting and recording of default service revenues and costs. These issues were fully addressed in PPL Electric's testimony and, in any event, currently are being audited by the Commission's Bureau of Audits, as required by law and as requested by OSBA. No further findings are required on these issues.

For all of these reasons, the relief requested by OSBA should be denied.

IV. ARGUMENT

A. **BURDEN OF PROOF**

The OSBA has raised two primary issues in this proceeding. First, the OSBA argues that PPL Electric's Section 1307(e) reconciliation methodology under its Commission-approved tariff is unreasonable. Second, OSBA is arguing that PPL Electric's reported undercollection for 2010 is incorrect. The OSBA bears the burden of proof with respect to both issues.

Tariffs that have been approved by the Commission have the force of law and are binding on both the utility and its customers. *Brockway Glass Co. v. Pa. P.U.C.*, 63 Pa. Cmwlth. 238, 437 A.2d 1067 (1981); *Behrend v. Bell Telephone Co.*, 242 Pa. Super. 47, 363 A.2d 1152 (1976). The burden of proving that an existing tariff provision is unreasonable or discriminatory is on the complainant. *Paul Kossman t/a Kossman Dev. Co. v. Pa. P.U.C.*, 694 A.2d 1147 (Pa. Cmwlth. 1997) ("*Kossman*"). In *Kossman*, the Commonwealth Court further stated as follows:

This burden is very heavy because tariff provisions that have been properly submitted to and approved by the Commission are *prima facie* reasonable. *Shenango Township Board of Supervisors v. Pa. P.U.C.*, 686 A.2d 910, 914 (Pa. Cmwlth. 1996).

In this proceeding, the OSBA is challenging PPL Electric's Section 1307(e) reconciliation methodology under its GSC-1 tariff. The GSC-1 tariff cost recovery mechanism was approved by the Commission in PPL Electric's POLR II proceeding. See PPL Electric St. 1, pp. 5-6. Moreover, PPL Electric has presented un rebutted evidence in this proceeding that its Section 1307(e) reconciliation methodology has not changed for over 30 years and is fully consistent with Commission practice and precedent. Tr. 51-52. The OSBA has a very heavy burden of proving that PPL Electric's reconciliation methodology under the Company's Commission-approved tariff is unreasonable. As explained below, the OSBA has not met its burden of proof.

In this proceeding, the OSBA also is challenging the amount of PPL Electric's undercollection for 2010. On page 2 of his testimony, Mr. Knecht states as follows:

The primary factor contributing to the large SC&I [small commercial and industrial] rate increase on June 1, 2011 was the reported need to recoup \$18.6 million in reported prior period cost under-recoveries.... As I explain below, these under-recoveries relate entirely to 2010.

The statements demonstrate that OSBA is challenging the Company's undercollection for 2010. As explained by Mr. Kleha, a Section 1307(e) reconciliation hearing was held regarding PPL Electric's 2010 GSC over/under collection balances for residential, small C&I and large C&I customer classes on February 8, 2011 before Your Honor at Docket No. M-2010-2213731. See PPL Electric St. 1, p. 8. The amount of the over/under collection was not disputed, was approved by Recommended Decision and by Order of the Commission entered April 14, 2011.

It is clear that PPL Electric had the burden of proof with respect to the amount of the 2010 GSC undercollection in the Section 1307(e) reconciliation proceeding. However, this amount was approved by the Commission and is now being challenged by the OSBA. PPL Electric clearly does not bear the burden of proving the amount of the undercollection twice, once in the reconciliation proceeding and again in this proceeding.

PPL Electric recognizes that Section 315 of the Public Utility Code, 66 Pa. C.S. § 315, provides that "upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be on the utility." However, the OSBA's complaint should not be characterized as a complaint against proposed rates for several reasons. First, OSBA is not challenging PPL Electric's projection of default service costs for the Application Period, but is challenging the amount of the undercollection for 2010, which, as explained above, already has been approved by the Commission in the Section 1307(e) reconciliation proceeding. Second, the OSBA's complaint is not related to the mathematical

calculation performed by PPL Electric to arrive at the GSC-1 rate or PPL Electric's projection of supply costs for the Application Period. Third, to the extent that the OSBA's complaint is not against the 2010 undercollection, it is against the methodology by which PPL Electric reconciles default service costs under its Commission-approved tariff. The law is clear that the complaining parties bear a heavy burden of proving that a Commission-approved tariff is not reasonable.

B. EXPLANATION OF THE COMPANY'S RECONCILIATION METHODOLOGY

1. Description Of A Section 1307(e) Cost Recovery Mechanism.

A Section 1307(e) cost recovery mechanism has two primary components. The first, the C factor, is a projection of costs for the application period. The second, the E factor, provides for the refund or recovery of prior over/undercollections. Tr. 39.

The formula set forth in the Company's tariff incorporates these two primary components:

$$GSC = \left[\frac{GSc - E}{S} \right] \times \frac{1}{(1-T)}$$

The tariff defines GSc as:

The total estimated direct and indirect costs incurred by the Company to acquire generation supply from all sources on behalf of BUSS customers in the applicable customer class.

The tariff defines E, in part as:

Experienced net over or undercollection of costs associated with the acquisition of generation supply . . .

The tariff defines S as:

The Company's total retail kWh sales to BUSS customers in the applicable customer class, projected for the computation quarter (c).

In addition, the tariff defines T as:

The Pennsylvania gross receipts tax rate in effect during the billing month, expressed in decimal form.

See OSBA Exhibit "C".

Under the tariff formula, the projected costs for the application period (GSC) are combined with the E factor and divided by projected sales. The gross receipt tax (T) is applied to this number to arrive at the overall GSC rate.

2. The 2010 Undercollection Amount of \$22.6 Million For Small C&I Customers Primarily Was Caused By A Difference In How Default Service Rates Initially Are Set And How They Are Reconciled Under A Section 1307(e) Cost Recovery Mechanism.

The issues in this proceeding center upon the E factor for PPL Electric's 2011 GSC-1 for small C&I customers. The 2011 E factor reflects over/under collections for 2010. PPL Electric experienced a substantial GSC-1 undercollection for 2010 for small C&I customers. This undercollection primarily was caused by a difference between how default service rates are initially determined and how costs and revenues are reconciled under a Section 1307(e) cost recovery mechanism. In order to set its initial default service rates for 2010, PPL Electric estimated its costs to acquire default supply for small C&I customers in 2010 and divided these costs by projected sales to small C&I customers according to the formula set forth above. Tr. 43.

PPL Electric's rate caps expired in December 2009. The GSC in 2010 was a new Section 1307(e) cost recovery mechanism and, as such, did not include an E factor balance for any prior period over or under collections. Therefore, pursuant to the Company's tariff, the 2010 GSC rate simply reflected projected costs for 2010 divided by projected sales with the resulting rate adjusted to reflect the gross receipts tax.

At the end of 2010, PPL Electric performed a reconciliation of the 2010 GSC costs as compared to the Company's actual billed revenues.² However, the actual billed revenues for January 2010 were prorated to eliminate the portion of those revenues for services rendered in December 2009. The Company always has prorated billed revenues in the first month of a new Section 1307(e) cost recovery mechanism. Moreover, the Company's generation rate caps expired on December 31, 2009. Therefore, the Company was legally required to prorate revenues (and not charge new rates for service rendered prior to December 31, 2009) in order to avoid breaking the rate caps. See 66 Pa. C.S. § 2804. Moreover, the Commission approved the Company's GSC rates for service rendered on and after January 1, 2010 and not for bills rendered on and after January 1, 2010. PPL Electric St. 1, p. 5.

Due to the effects of proration, the Section 1307(e) cost recovery mechanism for 2010 reconciled 12 months of costs with 11 ½ months of revenue resulting in an undercollection of the Company's costs. Schedule 2, page 2 of Exhibit JMK-1 shows the actual billed revenues by month (including the effects of proration) as compared to expenses and are set forth below:

² PPL Electric always has reconciled costs with actual billed revenues under its Section 1307(e) cost recovery mechanisms. It has never included unbilled revenues at the end of the reconciliation period. PPL Electric takes this approach for two reasons. First, it is required by the plain language of Section 1307(e). Second, unbilled revenues are estimates and not actual figures, and, therefore, cannot be meaningfully audited. For this reason, it is critical that the reconciliation data be based on actual data so the Commission can perform its statutory function of monitoring and auditing revenues and expenses recovered under Section 1307 rates.

Month	Billed Revenue Excluding GRT and MFC (line 5)	Total Expense (line 7)	Net Over/Under Collection (line 8)
January	\$34,297,496	\$63,519,471	(\$29,221,975)
February	\$45,142,778	\$43,208,965	\$1,933,813
March	\$31,707,030	\$34,871,605	(\$3,164,575)
April	\$26,062,683	\$25,296,497	(\$233,814)
May	\$20,937,135	\$21,158,905	(\$221,770)
June	\$22,476,027	\$16,719,674	\$4,758,353
July	\$23,398,351	\$26,104,517	(\$2,706,166)
August	\$22,170,551	\$19,493,006	\$2,677,545
September	\$20,286,444	\$17,244,055	\$3,042,389
October	\$17,672,264	\$18,165,489	(\$493,225)
November	\$16,146,286	\$18,008,009	(\$1,861,723)
December	\$19,490,897	\$17,686,918	\$1,803,979
TOTAL	\$298,787,942	\$321,477,111	(\$22,689,169)

As demonstrated by this Table, the net undercollection for January 2010 was \$29,221,975, while the total undercollection for calendar year 2010 was \$22,689,169. In effect, the entire undercollection for calendar year 2010 was a result of the January 2010 undercollection, which as explained above was caused by properly prorating the January 2010 revenues to exclude the portion of the revenue related to service provided in December 2009 from the Section 1307(e) reconciliation.

3. The Under Recovery Of Revenues Due To Proration Is Recovered Through The E-Factor Of A Section 1307(e) Cost Recovery Mechanism In Subsequent Application Periods.

As noted above, the E factor provides for the refund or recovery of prior period over/under collections. Tr. 39. Consistent with the tariffed formula set forth above, PPL Electric included the undercollection from 2010 in its E factor in the next Application Period for January 1, 2011 through May 31, 2011. The Company was not able to fully recover the undercollection in this Application Period. As a result, a portion of the 2010 undercollection balance has been carried over to subsequent application periods. As of August 31, 2011, the Company's remaining undercollection balance was approximately \$1.4 million for small C&I customers and it is likely that this balance will be recovered by the end of 2011. PPL Electric St. 1-RJ, p. 3.

Moreover, as explained herein, the large undercollection was a product of the initial proration of revenues and first year calculation of the clause and is not likely to happen again because the initial proration will not happen again under the GSC-1.

C. THE COMPANY'S RECONCILIATION METHODOLOGY "MAKES SENSE" AND SHOULD BE CONTINUED.

1. Cost Recovery Under Section 1307(e) Mechanism Is Properly Reviewed Over A Two-Year Period.

In testimony, the OSBA argues that PPL Electric's reconciliation approach mismatches 11 ½ months of revenue with 12 months of costs during the first application period, and that this is not appropriate. OSBA St. 2, p. 6. The OSBA fails to recognize the effects of the E-factor in subsequent application periods. The "missing" ½ month of revenue in year one is included in the E-factor in subsequent application periods. As explained by Mr. Kleha, over a two-year period, there is a full matching of 24 months of actual incurred costs and 24 months of actual billed revenue under a Section 1307(e) cost recovery mechanism. PPL Electric St. 1-RJ, p. 10.

A reconcilable Section 1307(e) mechanism is an ongoing cost recovery mechanism that allows a utility to fully recover its costs over a two-year period. Therefore, it is not appropriate to look at a single application period in isolation under a Section 1307(e) cost recovery mechanism. For example, PPL Electric is billed for many of its costs by PJM Interconnection, LLC (“PJM”). PPL Electric’s witness, Mr. Woodruff, explained in this proceeding that PJM bills PPL Electric under two separate settlements, Settlement A and Settlement B. Settlement A is a daily settlement that is based on the prior day’s load. Settlement A is estimated because actual daily meter readings are not available for most residential and small C&I customers. PPL Electric St. 2-R, p. 10. After all meter reads are completed and the data is verified, there is a second Settlement B which occurs two months later. PPL Electric St. 2-R, p. 10. As a result, PPL Electric may incur costs or receive credits under the PJM Settlement B process that are associated with service provided in a prior application period. In addition, the Settlement B amounts can be quite substantial. For April 2010, the Settlement B amount for small C&I customers was a credit of \$7,721,849 or approximately 25% of the Settlement A amount of \$31,109,626. See PPL Electric St. 2-R, p. 11.

This example shows the futility in trying to view one Application Period as a single snapshot. All costs and revenues associated with service provided in a single application period cannot be included in that application period because PPL Electric does not know what all of the actual costs are for that application period until at least two months after the costs are incurred.

2. The Reconciliation Methodology Employed By PPL Electric And Other EDCs Is Consistent With Over 30 Years Of Uniform Commission Practice And Precedent.

One of PPL Electric’s witnesses in this proceeding was Mr. Joseph Kleha. It is clear that Mr. Kleha is one of the leading experts, if not the leading expert, on reconciliation methodology in Pennsylvania. Mr. Kleha was involved in the development of the original reconcilable energy

clauses in the 1970s as a Fixed Utility Analyst at the Commission. Tr. 51. Mr. Kleha has continued to work on reconciliation issues over the past 35 years both at the Commission and at PPL Electric.

Mr. Kleha explained and it is undisputed in this proceeding that PPL Electric's reconciliation methodology is consistent with over 30 years of Commission practice and procedure and with the methodologies employed other utilities to reconcile Section 1307(e) cost recovery mechanisms. Tr. 52. It is telling that the Commission's I & E Bureau participated in this proceeding and did not dispute any of Mr. Kleha's testimony.

The Commission should not overturn 30 years of practice and precedent in this proceeding. While the Commission is not bound by the rule of *stare decisis*, the Commission must render consistent opinions and should either follow, distinguish, or overrule its own precedent. *Bell Atl. v. Pa. P.U.C.*, 672 A.2d 352, (Pa. Cmwlth., 1995); citing *Pennsylvania Trust v. Dep't of Env'tl. Prot.*, 863 A.2d 93, 107 (Pa. Cmwlth. 2004). As explained further below, the OSBA has not presented sufficient justification for the Commission to overrule 30 years of practice and procedure in this proceeding.

3. The Reconciliation Methodology Employed By PPL Electric Provides A Necessary And Appropriate Form Of Cash Working Capital Allowance To Reflect The Undisputed Lag Between Payment Of Default Service Expenses And Receipt Of Default Service Revenues And Is An Essential Component Of Full And Current Cost Recovery.

As explained by Mr. Kleha, there is a lag between when default supply costs are incurred by the Company and when customers' payments are received by the Company. PPL Electric St. 1-R, p. 8. This creates a cash working capital requirement. PPL Electric St. 1-R, p. 8. Mr. Kleha also explained that a utility only receives interest on a Section 1307(e) undercollection balance from the month that the undercollection occurs until the mid-point of the subsequent

application period over which the undercollection is projected to be recovered. PPL Electric St. 1-R, p. 10.

PPL Electric does not receive any working capital allowance in base rates for its Section 1307(e) over or under collections. PPL Electric St. 1-R, p. 10. The methodology of reconciling actual incurred costs against actual billed revenues under a Section 1307(e) cost recovery mechanism provides PPL Electric with a form of cash working capital allowance for the lag in recovering default service costs. PPL Electric St. 1-R, p. 10.³

Both the Commission and the Courts have recognized that EDCs are entitled to recover cash working capital costs. The Courts have long held that utilities are permitted to recover a cash working capital requirement in rates. See *Pennsylvania Power & Light Co. v. Commonwealth of Pa.*, 668 A.2d 620, 621 (Pa. Cmwlth. 1995). In addition, the Commission has specifically recognized that cash working capital is a cost element of providing default service. See 52 Pa. Code § 69.1808(a)(4).

In testimony, Mr. Knecht proposes that the Company forecast its working capital requirements and include them in its next default service case. OSBA St. 2, p. 9. PPL Electric disagrees with his proposal for several reasons. First, the reconciliation methodology already provides PPL Electric with a cash working capital requirement associated with providing default service. This methodology is simple and includes the cash working capital requirement in the price to compare (“PTC”) because the over/under collection is included in the PTC. Second, if OSBA’s proposal were adopted it would prevent PPL Electric from recovering any cash working capital requirement associated with its GSC-1 until after its next default service procurement plan or distribution rate request is approved. It is not reasonable or appropriate to change the

³ OSBA does not deny that PPL Electric has a working capital requirement associated with its Section 1307(e) cost recovery mechanisms. See OSBA St. 2, pp. 8-9.

Company's reconciliation methodology without providing another mechanism for PPL Electric to fully and currently recover its working capital allowance. PPL Electric St. 1-R, p. 10.

4. The Reconciliation Methodology Provides A Simple, Verifiable Basis For Commission Staff To Audit The GSC-1

Under its GSC-1, the Company reconciles actual billed revenues with actual incurred costs for each application period. This is how the Company always has reconciled revenues and costs under its Section 1307(e) cost recovery mechanisms. PPL Electric St. 1-R, pp. 6-7.

When Commission staff audits PPL Electric's Section 1307(e) cost recovery mechanism, they compare actual billed revenue amounts with actual incurred costs for each application period. PPL Electric St. 1-RJ, pp. 4-5; Tr. 38. In his Rejoinder Testimony, Mr. Kleha stated as follows:

In fact, the auditors test the accuracy of PPL Electric's calculation of customers' actual bills as part of their audit procedures, not its estimation of unbilled revenue. I would note that, from an auditor's perspective, a true reconciliation reflects only actual results, i.e., a comparison of actual incurred expenses to actual billed revenue. Accordingly, a comparison of actual incurred expenses to some amount of actual billed revenue plus some amount of estimated unbilled revenue does not constitute a true reconciliation. For these reasons, PPL Electric's Section 1307(e) reconciliation procedures, which are appropriate and in full compliance with this Commission's practice and precedent, should not be changed.

PPL Electric St. 1-RJ, p. 5.

The Company's methodology of reconciling billed revenues with actual incurred costs is consistent with how the Commission's staff audits the GSC and GSC-1. Adopting OSBA's proposal to include estimates of unbilled revenues in or exclude certain costs from the GSC and/or GSC-1 reconciliation would make it more difficult for audit staff to meaningfully audit the GSC and GSC-1.

D. THE SUBSTANTIAL INCREASE IN THE JUNE 1, 2011 SMALL C&I DEFAULT SERVICE RATE PRIMARILY WAS THE RESULT OF QUARTERLY RECONCILIATION.

PPL Electric recognizes that small C&I default service customers experienced a significant rate increase on June 1, 2011, due to the E factor component of the rate. However, this rate increase was not caused primarily by proration, but, rather, was caused by the requirement that PPL Electric reconcile costs on a quarterly basis.

In its CBP proceeding, PPL Electric proposed to reconcile default service costs on an annual basis under its GSC. Tr. 31. However, in the CBP Order, the Commission required PPL Electric to reconcile default service costs quarterly, as opposed to annually. See CBP Order, p. 54. As explained by Mr. Kleha at the hearing:

When we entered into the CBP when we filed it and through most of the case until the very end, we were proposing an annual charge that would be reconciled on an annual basis. We were reconciling the entire [year] of 2010 in 2011. That's the way the mechanism is designed to work.

Unfortunately, the Commission -- in my view unfortunately -- the Commission changed the rules I guess in response to Act 129 and said we're going to do changes quarterly. And, once you start doing changes quarterly, your application period changes. Instead of being a calendar year period, it now becomes a quarterly period. And, for PPL Electric in 2011, our first quarter was not actually a quarter but it was five months long until we got onto the PJM planning period. It was also where we were supposed to go in order to be able to facilitate proper -- excuse me, acquisition of our generation supply charges.

So, rather than being able to recover all of the dollars that were undercollected in 2010 over a 12-month period of time, the company was forced to try to recover them in a five-month period. It did not recover them because shopping had increased, and there were a fewer number of customers who were taking service under the GS-1 and GSC rate schedules; and, once you have a lower customer base, every customer who remains pays a higher rate in order to cover the costs of the undercollection that was generated in 2010.

Tr. 31-32.

If PPL Electric had been allowed to reconcile costs on an annual basis, default service customers rates would have been much more stable. The E factor rates for each Application Period in 2011 are shown on PPL Electric Hearing Exhibit 1. If the E factor rates for January through November are averaged over the 11 month period (as a proxy), the resulting E factor rate is 2.154 ¢ per kWh.⁴ The table below shows the impact on the total rate if the average E factor rate is applied.

Application Period	Total Rate	C Factor Rate	Average E Factor Rate⁵
January 1, 2010 – December 31, 2010	10.125 ¢ per kWh	10.125 ¢ per kWh	0
January 1, 2011 – May 31, 2011	10.447 ¢ per kWh	8.293 ¢ per kWh	2.154 ¢ per kWh
June 1, 2011 – August 31, 2011	10.171 ¢ per kWh	8.017 ¢ per kWh	2.154 ¢ per kWh
September 1, 2011 – November 30, 2011	9.366 ¢ per kWh	7.212 ¢ per kWh	2.154 ¢ per kWh

When comparing the results above to the results shown on PPL Electric Hearing Exhibit 1, it is evident that rates would have been much more stable under an annual reconciliation approach. The total default service rates above vary little more than 1¢ per kWh over the entire period, with the largest adjustment from one period to the next at 0.805¢ per kWh for the rate change that occurred on September 1, 2011. The rate variation on PPL Electric Hearing Exhibit No. 1 was 2.895¢ per kWh with the largest single period adjustment of 2.895¢ occurring on June 1, 2011. Under the example above, if the Company had been permitted to adopt annual reconciliation, default service rates would be increased by 3.2% on January 2011, decreased by 2.6% June 1, 2011 and decreased by 7.9% on September 1, 2011. This is quite different than the

⁴ The average E factor rate is determined by adding the individual E factor rates for January through November and dividing by 11.

⁵ PPL Electric recognizes that the average E factor rate above may not be the exact rate that would have been applied if PPL Electric had been permitted to reconcile costs on an annual basis. However, it is a reasonable proxy which demonstrates that rates could have been much more stable.

results shown on PPL Electric Hearing Exhibit No. 1 where default service rates decreased by 8% on January 1, 2011, increased by 31% on June 1, 2011 and decreased by 23% on September 1, 2011. Annual reconciliation would clearly stabilize rates.

E. PPL ELECTRIC DOES NOT ANTICIPATE THAT CUSTOMERS WILL NOT EXPERIENCE SIGNIFICANT RATE FLUCTUATIONS DUE TO PRORATION IN THE FUTURE

As explained by Mr. Kleha, the proration of revenues in January 2010 was necessary due to the initial implementation of the new Section 1307(e) cost recovery mechanism. See PPL Electric St. 1-R, p. 5. The Company does not expect to experience the significant proration affects again that it experienced in January 2010 because reconciliation balances of this magnitude generally arise only when a new Section 1307(e) cost recovery mechanism is implemented.

Moreover, as explained by Mr. Kleha, the Company has filed for Commission approval of a Reconciliation Rider at Docket No. P-2011-2256365. PPL Electric St. 1-RJ, p. 12. The Reconciliation Rider will help mitigate any future rate instability caused by the reconciliation of over or undercollections.

F. THE OSBA'S PROPOSED SOLUTIONS WOULD VIOLATE SECTION 1307(E) AND ARE OTHERWISE UNREASONABLE.

1. The OSBA's Proposed Solutions Violate Section 1307(e) And Commission Practice and Precedent Regarding Proration And The Proper Ratemaking Treatment of Unbilled Revenues.

In direct testimony, the OSBA proposes two different alternatives for how PPL Electric could reconcile costs and revenues under its GSC-1. The first alternative is that PPL Electric reflect revenues associated with unbilled kWh in the last month of the reconciliation period. OSBA St. 1, p. 9. The second alternative is that PPL Electric exclude costs related to unbilled kWh from the reconciliation calculation. OSBA St. 1, p. 9. These alternatives are contrary to

Commission practice regarding the reconciliation of a Section 1307(e) cost recovery mechanism for more than 30 years and also are contrary to the plain language of Section 1307(e).

Section 1307(e) of the Code, 66 Pa. C.S. § 1307(e) provides as follows:

(e) Automatic adjustment reports and proceedings

(1) Within 30 days following the end of such 12-month period as the commission shall designate, each public utility using an automatic adjustment clause shall file with the commission a statement which shall specify for such period:

- (i) the **total revenues received** pursuant to the automatic adjustment clause;
- (ii) the **total amount of that expense or class of expenses incurred** which is the basis of the automatic adjustment clause; and
- (iii) the difference between the amounts specified by subparagraphs (i) and (ii).

Emphasis supplied.

OSBA's first recommendation is that PPL Electric include unbilled revenues in its reconciliation methodology. Unbilled revenues clearly are not revenues that have been received by the Company. Indeed, unbilled revenues have not yet been billed, much less collected. OSBA's proposal, therefore, is clearly at odds with the plain language of Section 1307(e) quoted above. As explained by Mr. Kleha, the Commission's long-standing practice is to use actual billed revenues in the reconciliation of a Section 1307(e) cost recovery mechanism. PPL Electric St. 1-R, p. 6; Tr. 49. According to Mr. Kleha, who has over 30 years experience with Section 1307(e) cost recovery mechanisms and also helped to develop automatic adjustment clauses for utilities in his role as a Fixed Utility Analyst in the Commission's Bureau of Rates and Research in the 1970's, utilities do not use unbilled revenues in the reconciliation of a Section 1307(e) cost recovery mechanism. Tr. 49. At the hearing in this proceeding, Mr. Kleha stated as follows:

You can't have a true reconciliation of costs that are actual to revenues that are an estimate. That is not a reconciliation. You can't verify that number. It's going to change because it's an estimate. An actual number is an actual number that can be verified; and, from an audit perspective, that's exactly what the auditors in this agency do....

Tr. 49.

In this proceeding, Mr. Kleha has explained on several occasions that the Commission does not consider unbilled revenues in the reconciliation of a Section 1307(e) cost recovery mechanism. It is important to recognize that his testimony on this subject has not been rebutted or disputed by the OSBA. At no point in this proceeding has the OSBA ever alleged that Mr. Kleha is incorrect on this point.

Moreover, on multiple occasions, the Commission has held that unbilled revenues are not considered when forecasting future test year revenues in a base rate proceeding. In PPL Electric's 2004 rate case, the United States Department of Defense and Federal Executive Agencies ("USDOD") argued that unbilled revenues should be included in future test year revenue projections. *Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-00049255, et al., 2004 Pa. PUC LEXIS 40 *17, Order entered December 2, 2004. USDOD argued that the Company uses estimated budget figures to project the future test year claim and that excluding unbilled revenue created a mismatch between revenues and expenses for the accounting period. USDOD also argued that PPL Electric included unbilled revenues for accounting and tax reporting purposes. *Id.* According to the Commission, the ALJ found that USDOD "confused the concepts of adjustments for accounting and tax purposes with the annualization and normalization adjustments used in forecasting test year revenues and expenses for ratemaking purposes..." *Id.* At *17 - *18. The Commission noted that it agreed with the ALJ on this issue. Many other Commission decisions have held that unbilled revenues are not considered when forecasting test year revenues in a base rate proceeding. See e.g., *Pa. P.U.C. v. Metropolitan*

Edison Co., Docket No. R-00922314 et al, 1993 Pa. PUC LEXIS 41, *51-*55, Order entered January 21, 1993; *Pa. P.U.C. v. Western Pa. Water Co.*, Docket No. R-850096 et al, 1986 Pa. PUC LEXIS 147, 37-*38, Order entered January 29, 1986.

Like the USDOD in PPL Electric's 2004 base rate proceeding, the OSBA is confusing accounting principles with proper ratemaking principles. The Commission does not consider unbilled revenues for ratemaking purposes in Pennsylvania.

Even in the face of clear and substantial evidence that the OSBA's proposal to include unbilled revenues in the reconciliation calculation is contrary to Commission precedent and practice, the OSBA continues to advance its proposal. In testimony, the OSBA argues that it is wrong for PPL Electric to "slavishly adhere to Commission precedent." OSBA St. 2, p. 4. As explained by Mr. Kleha, PPL Electric cannot ignore Commission precedent when calculating and reconciling its Section 1307(e) cost recovery mechanism. PPL Electric St. 1-RJ, p. 4. Nor can PPL Electric ignore the plain language of Section 1307(e).

OSBA's second alternative is for PPL Electric to exclude costs related to unbilled kWh from the reconciliation calculation. OSBA St. 1, p. 9. The Company includes actual incurred costs in its reconciliation calculation. PPL Electric St. 1-R, p. 6. This is consistent with Section 1307(e)(1)(ii) which provides that utilities are to include total incurred expenses in the reconciliation of a Section 1307(e) cost recovery mechanism. 66 Pa. C.S. § 1307(e)(1)(ii). The OSBA proposal to exclude costs would violate Section 1307(e)(1)(ii). As explained above, the OSBA proposal to exclude costs from the reconciliation calculation also would violate over 30 years of Commission precedent, as well as the accounting guidance under ASC 980. See PPL Electric St. 1-R, p. 7.

2. The OSBA's Proposed Solutions Would Deny PPL Electric Recovery Of A Form Of Cash Working Capital Allowance And Would Prevent Full And Current Cost Recovery.

As explained above, PPL Electric has a cash working capital requirement associated with providing default service to customers and recovers this requirement through application of the GSC-1. The proration methodology and inclusion of only billed revenues effectively provides a form of working capital allowance. PPL Electric St. No. 1-R, p. 10. If either of the OSBA's proposals were adopted, they would eliminate PPL Electric's ability to recover a cash working capital requirement. PPL Electric is entitled to full recovery of its default service costs under Act 129. 66 Pa. C.S. § 2807(e)(3.9). And, the Commission has specifically ruled that cash working capital is a component of POLR costs. Therefore, the OSBA's proposals cannot be lawfully adopted without otherwise providing for the Company to recover its cash working capital costs.

3. The OSBA's Proposed Solutions Are Inconsistent With How The Commission's Bureau Of Audits Reviews And Confirms The Accuracy Of PPL Electric's GSC And GSC-1 Rates.

As explained above, when Commission staff audits the Company's GSC and GSC-1, they review billed revenues with actual incurred costs for each application period. Tr. 49. The OSBA's proposals for the Company to include unbilled revenues in the GSC and GSC-1 or to exclude costs are inconsistent with how Commission staff audits the GSC and GSC-1, and would create additional complexity. Such a dramatic change in methodology should not be adopted without input from the Commission's Bureau of Audits.

G. OSBA'S RATE STABILITY CONCERNS ARE OVERSTATED

1. OSBA Overstates The Importance Of Rate Stability Under Act 129

Throughout his direct and surrebuttal testimony, Mr. Knecht places great emphasis on rate stability as a goal for default service rates. OSBA St. 1, p. 4; OSBA St. 2, pp. 1-2. While

rate stability is one factor addressed by Act 129, Mr. Knecht clearly is overstating its importance. The Commission's regulations provide for quarterly, or more frequent, adjustment of default service rates. 52 Pa. Code § 54.187. If rate stability is such a concern, the Commission would not require rates to change so frequently. Moreover, generation supply charges can fluctuate significantly based upon changes in market prices. PPL Electric St. 1-RJ, p. 2. While rate stability is one factor to consider, it is not a central component under Act 129. Rather, Act 129 focuses on competitive procurements and cost recovery. See 66 Pa. C.S. §§ 2807(e)(3.1), (3.2), (3.4) and (3.9).

2. As Anticipated, The Company's E Factor Has Stabilized Over The 24-Month Review Period Appropriate For Section 1307(e) Cost Recovery Mechanisms.

Mr. Knecht fails to place sufficient emphasis on the fact that PPL Electric's undercollection balance for small C&I customers has declined significantly. PPL Electric default service rates for small C&I customers have stabilized as the Company has recovered its undercollections. The undercollection for small C&I customers has been reduced to approximately \$1.4 million as of August 31, 2011. See PPL Electric Hearing Exh. No. 1. The "problem" identified by OSBA already has been solved and as explained above, is not likely to recur. And, in any event, there are other, more appropriate mechanisms to deal with this issue prospectively, e.g., annual reconciliation of the GSC-1 and adoption of a Reconciliation Rider.

3. Small C&I Rates Would Not Have Fluctuated So Significantly If PPL Electric Had Been Permitted To Reconcile On An Annual Basis.

The rate fluctuations experienced by the Company's small C&I customers would not have been nearly as significant if the Commission had adopted PPL Electric's original proposal to reconcile default service rates. In PPL Electric's CBP proceeding, PPL Electric proposed to reconcile default service costs on an annual basis. See CBP Order p. 54. However, the Commission required PPL Electric to reconcile on a quarterly basis. *Id.* If PPL Electric had

been able to reconcile its default service costs on an annual basis, the impact on customers would have been much lower. As a result, the “problem” here, if there is a “problem”, was caused largely by quarterly reconciliation of the GSC-1 and not by the Section 1307(e) reconciliation methodology employed by PPL Electric.

H. IF ANY CHANGES ARE MADE IN THIS PROCEEDING, THEY SHOULD NOT BE MADE TO THE COMPANY’S RECONCILIATION METHODOLOGY

As explained above, PPL Electric’s reconciliation methodology is fully consistent with Section 1307(e) of the Public Utility Code, fully consistent with long-standing Commission precedent and fully consistent with how the Company has reconciled costs and recoveries for over 30 years. PPL Electric has explained that its reconciliation methodology makes sense and that the true cause of the rate fluctuations was quarterly reconciliation. Therefore, if any changes are made, they should address the root cause and allow the Company to adopt annual reconciliation. PPL Electric notes that the Commission currently is seeking comments from parties regarding the benefits of six-month reconciliation adjustments. *Investigation of Pennsylvania’s Retail Electricity Market: Recommended Directives on Upcoming Default Service Plans*, Docket No. I-2011-2237952, Tentative Order entered October 14, 2011, p. 7. Another solution would be to adopt PPL Electric’s Reconciliation Rider proposal at Docket No. P-2011-2256365. See PPL Electric St. No. 1-RJ, pp. 12-13.

I. ANY CHANGES TO PPL ELECTRIC’S RECONCILIATION METHODOLOGY SHOULD ONLY BE DONE IN A STATEWIDE PROCEEDING AND ONLY ON A PROSPECTIVE BASIS

As explained above, it is undisputed in this proceeding that PPL Electric has implemented numerous Section 1307(e) cost recovery mechanisms over the past 30 years and that all of these mechanisms were reconciled in the same manner that PPL Electric is reconciling the GSC and GSC-1. PPL Electric St. 1-RJ, p. 4. It is undisputed that PPL Electric has been

following long-established Commission precedent and practice in matching actual billed revenue with actual incurred costs for each application period. PPL Electric St. 1-R, p. 3. Also, it is undisputed that the Commission's Bureau of Audits reviews actual billed revenue amounts and actual incurred costs for each Application Period when auditing the GSC and GSC-1.

Despite these undisputed facts, the OSBA is asking that PPL Electric abandon its reconciliation procedures which have been employed for over 30 years and abandon long-standing Commission precedent and practice to implement a significant change in the Company's reconciliation methodology. As explained above, the OSBA bears a heavy burden in proving that PPL Electric's reconciliation methodology under its Commission approved tariff is unreasonable. *Paul Kossman t/a Kossman Dev. Co. v. Pa. P.U.C.*, 694 A.2d 1147 (Pa. Cmwlth. 1997). PPL Electric has explained the many reasons why it disagrees with the OSBA's request. However, to the extent that the Commission believes that any changes are appropriate, these changes should be implemented only after a statewide proceeding and only on a prospective basis.

OSBA is requesting a significant policy change with regard to how costs and revenues are calculated in the reconciliation of a Section 1307(e) cost recovery mechanism. This obviously will affect a large number of utilities in the Commonwealth and also will likely affect how the Bureau of Audits reviews Section 1307(e) cost recovery mechanisms. Due to the potential broad impact, PPL Electric does not believe that any changes should be made on a single utility basis, but should only be made in a generic proceeding where all utilities have the opportunity to comment.

Moreover, any changes should only be made on a prospective basis. As explained above, the reconciliation methodology provides PPL Electric with a form of cash working capital allowance. Any retroactive changes could deny PPL Electric the ability to recover its cash

working capital requirement for providing default service for the retroactive time period and deny it full and current cost recovery required by Act 129. Section 2807(e)(3.9) for the Public Utility Code provides as follows:

“The default service provider shall have the right to recover on a full and current basis, pursuant to a reconciliation automatic adjustment clause under Section 1307 (relative to sliding scale of rates; adjustments), all reasonable costs incurred under this section and a Commission-approved competitive procurement plan.”

In addition, retroactive changes to the reconciliation methodology also could cause significant customer confusion and disrupt the competitive market. If PPL Electric is required to include unbilled revenue in the GSC-1 calculation or exclude costs from the calculation, a “phantom” over-collection would be created and then refunded to customers. Because the Company reconciles costs and recoveries on a quarterly basis, it is likely that the phantom over-collection would significantly reduce rates. This could create a false price signal for customers and cause a significant number of customers to return to default service, thereby disrupting the competitive market. PPL Electric does not believe that such PTC disruptions would be consistent with the Commission’s recent efforts to promote retail competition.

J. THE COMMISSION’S AUDIT STAFF IS CURRENTLY AUDITING PPL ELECTRIC’S GSC AND GSC-1 COST RECOVERY MECHANISM

One of OSBA’s primary recommendations in this proceeding is that the Commission’s Bureau of Audits conducts a detailed audit of PPL Electric costs and recoveries under its GSC and GSC-1 mechanisms. See OSBA St. 1, p. 31. As explained by Mr. Kleha, the Bureau of Audits already is on-site at PPL Electric conducting an audit of PPL Electric’s 2010 GSC and 2011 GSC-1. If the Commission’s Bureau of Audits identifies any issues with the GSC and GSC-1, PPL Electric will work with audit staff to address such issues. Therefore, OSBA’s recommendations in this proceeding are unnecessary.

K. PPL ELECTRIC HAS NOT UNDER-REPORTED REVENUES

In testimony, Mr. Knecht claims that PPL Electric under-recorded default service revenues for 2010. OSBA St. 1, p. 20. As PPL Electric's witness, David R. Woodruff, explained in his testimony, the Company had to rely on a number of estimates in determining default service revenues in 2010. PPL Electric St. 2-R, p. 8. As further explained by Mr. Woodruff, PPL Electric included all actual billed default service revenues and incurred costs in its GSC and GSC-1 charges and all revenues and costs are being audited by Commission staff. PPL Electric St. 2-RJ, p. 2. If the Company under-reported revenues, and it did not, Commission staff will identify it in its ongoing audit and PPL Electric will correct it. PPL Electric St. 2-RJ, p. 2.

V. CONCLUSION

The un rebutted evidence in this proceeding demonstrates that PPL Electric's reconciliation methodology is consistent with long-standing Commission practice and precedent. Any issue with the small C&I undercollection has resolved itself through the normal operation of the GSC-1. The OSBA's proposal to modify the Company's Section 1307(e) reconciliation methodology should not be accepted, and the OSBA's complaint should be dismissed.

Respectfully submitted,



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Appendix A

APPENDIX A

I. PROPOSED FINDINGS OF FACT

PPL Electric Utilities Corporation ("PPL Electric" or the "Company") proposes the following findings of fact:

1. On August 2, 2006, PPL Electric filed its Petition for Approval of a Competitive Bridge Plan ("CBP") to establish terms and conditions under which the Company would provide Default Service (or Provider of Last Resort service) during calendar year 2010, as a transition to a fully competitive market beginning January 1, 2011. (PPL Electric St. No. 1, p. 4).

2. As part of the CBP, PPL Electric proposed to implement a new rate rider, the GSC. As proposed, the GSC was an automatic Section 1307(e) cost recovery mechanism that provided for annual reconciliation of any over or under collection of the Company's actual costs incurred to acquire generation supply on behalf of each of three Customer Classes (Residential, Small Commercial and Industrial ("Small C&I") and Large Commercial and Industrial ("Large C&I")). (PPL Electric St. No. 1, p. 4).

3. The Commission approved the CBP, as modified, in its Opinion and Order, entered May 17, 2007, at Docket No. P-00062227. (PPL Electric St. No. 1, pp. 4-5).

4. In its compliance filing, PPL Electric submitted the approved GSC tariff rider, which provided for the GSC to be re-calculated and reconciled on a quarterly basis pursuant to the Commission's Order, to become effective for service rendered on and after January 1, 2010. (PPL Electric St. No. 1, p. 5).

5. On August 28, 2008, PPL Electric filed with the Commission its Petition for Approval of a Default Service Program and Procurement Plan for the period January 1, 2011 through May 31, 2013 ("DSPP"). (PPL Electric St. No. 1, p. 5).

6. As part of the DSPP, PPL Electric proposed to implement a new rate rider, the GSC-1, which would replace the GSC for the Residential and Small C&I Customer Classes, beginning January 1, 2011. (PPL Electric St. No. 1, p. 5).

7. The GSC-1 is an automatic Section 1307(e) cost recovery mechanism that provides for quarterly re-calculation of the GSC-1 rates and quarterly reconciliation of any over or under collection of the Company's actual costs incurred to acquire generation supply on behalf of the Residential and Small C&I Customer Classes. (PPL Electric St. No. 1, p. 5).

8. In a Recommended Decision issued on April 16, 2009, the presiding ALJ recommended that the Joint Petition for Settlement among the parties regarding the DSPP be adopted without modification. The Commission approved the Joint Petition for Settlement in its Opinion and Order, entered on June 30, 2009, at Docket No. P-2008-2060309. (PPL Electric St. No. 1, p. 5).

9. In its compliance filing, PPL Electric submitted the approved GSC-1 tariff rider, which provided for the initial computation quarter of the GSC-1 to include any applicable over or under collection related to the 2010 GSC for the Residential and Small C&I Customer Classes, to become effective for service rendered on and after January 1, 2011. (PPL Electric St. No. 1, pp. 5-6).

10. On February 8, 2011, a Section 1307(e) reconciliation hearing was held regarding PPL Electric's 2010 GSC over or under collection balances for the Residential, Small C&I and Large C&I Customer Classes at Docket No. M-2010-2213731. (PPL Electric St. No. 1, p. 8).

11. In a Recommended Decision issued on February 28, 2011, the presiding ALJ recommended acceptance of the Company's reconciliation of the 2010 GSC because it was not

disputed. In its Order entered on April 14, 2011, the Commission adopted as its own action the Recommended Decision of the ALJ. (PPL Electric St. No. 1, p. 8).

12. PPL Electric's accounting records and practices are maintained and applied in compliance with GAAP, guidance of the Financial Accounting Standards Board ("FASB"), Accounting Standards Codification 980, Regulated Operations ("ASC 980"), and the FERC's Uniform System of Accounts. (PPL Electric St. No. 1-R, p. 6).

13. PPL Electric's accounting records are audited annually by an independent accounting firm. (PPL Electric St. No. 1-R, p. 6).

14. PPL Electric's regulatory accounting records and practices are fully consistent with this Commission's policies, practices and procedures. (PPL Electric St. No. 1-R, p. 6).

15. Pursuant to PPL Electric's tariff, the 2010 GSC rate reflected projected costs for 2010, divided by projected sales, with the resulting rate adjusted to reflect the gross receipts tax. (TR. 43).

16. At the end of 2010, PPL Electric performed a reconciliation of the 2010 GSC costs as compared to the Company's actual billed revenues. The actual billed revenues for January 2010 were prorated to eliminate the portion of those revenues for services rendered in December 2009. (PPL Electric St. No. 1-RJ, 11).

17. The proration of revenues in January 2010 was necessary, due to the initial implementation of the new Section 1307(e) cost recovery mechanism. (PPL Electric St. No. 1-R, p. 5).

18. Due to the effects of proration, the 1307(e) reconciliation mechanism reconciled 12 months of costs with 11 ½ months of revenue resulting in an undercollection of the Company's costs. (Schedule 2, page 2 of Exhibit JMK-1).

19. The Company was not able to fully recover the undercollection between January 1, 2011 and May 31, 2011. As a result, a portion of the 2010 undercollection balance has been carried over to subsequent application periods. (PPL Electric St. No. 1-RJ, 7).

20. As of August 31, 2011, the Company's remaining undercollection balance was approximately \$1.4 million for small C&I customers. It is likely that this balance will be recovered by the end of 2011. (PPL Electric St. No. 1-RJ, p. 3).

21. A Section 1307(e) cost recovery mechanism has two primary components. The first, the C factor, is a projection of costs for the application period. The second, the E factor, provides for the refund or recovery of prior period over/under collections. (Tr. 39).

22. Over a two-year period, there is a full matching of 24 months of actual incurred costs and 24 months of actual billed revenue under a Section 1307(e) cost recovery mechanism. (PPL Electric St. No. 1-RJ, p. 10).

23. All costs and revenues associated with service provided in a single application period cannot be included in that application period, because PPL Electric does not know what all of the actual costs are for that application period until at least two months after the costs are incurred. (PPL Electric St. No. 2-R, pp. 10-12).

24. PPL Electric's reconciliation methodology is consistent with over 30 years of Commission practice and procedure and with the methodologies employed by other utilities to reconcile Section 1307(e) cost recovery mechanisms. (Tr. 52).

25. PPL Electric has implemented numerous Section 1307(e) cost recovery mechanisms over the past 30 years and all of these mechanisms were reconciled in the same manner that PPL Electric is reconciling the GSC-1. (PPL Electric St. No. 1-RJ, p. 4).

26. PPL Electric has been following long-established Commission precedent and practice in matching actual billed revenue with actual incurred costs for each application period. (PPL Electric St. No. 1-R, p. 3).

27. When Commission staff audits PPL Electric's Section 1307(e) cost recovery mechanisms, they compare actual billed revenue amounts with actual incurred costs for each application period. (PPL Electric St. No. 1-RJ, pp. 4-5; Tr. 38).

28. The Company's methodology of reconciling actual billed revenues with actual incurred costs is consistent with how the Commission's staff audits the GSC-1. (Tr. 38).

29. The Commission does not consider unbilled revenues in the reconciliation of a Section 1307(e) cost recovery mechanism. (PPL Electric St. No. 1-RJ, p. 5).

30. There is a lag between when default supply costs are incurred by the Company and when customers' payments are received by the Company which creates a cash working capital requirement. (PPL Electric St. No. 1-R, p. 8).

31. PPL Electric only receives interest on a Section 1307(e) undercollection balance from the month that the undercollection occurs until the mid-point of the subsequent application period over which the undercollection is projected to be recovered. (PPL Electric St. No. 1-R, p. 10).

32. PPL Electric does not receive any working capital allowance in base rates for its Section 1307(e) over or under collections. (PPL Electric St. No. 1-R, p. 10).

33. The methodology of reconciling actual incurred costs against actual billed revenues under a Section 1307(e) cost recovery mechanism provides PPL Electric with a form of cash working capital allowance for the lag in recovering default service costs. (PPL Electric St. No. 1-R, p. 10).

34. It is not reasonable or appropriate to change the Company's reconciliation methodology before providing another mechanism for PPL Electric to recover its working capital allowance. (PPL Electric St. No. 1-R, p. 10).

35. PPL Electric proposed to reconcile default service costs on an annual basis under its GSC in its CBP Proceeding. (Tr. 31).

36. In the CBP Order, the Commission required PPL Electric to reconcile default service costs quarterly, as opposed to annually. (Tr. 31).

37. Generation supply charges can fluctuate significantly based upon changes in market prices. (PPL Electric St. No. 1-RJ, p. 2).

38. PPL Electric default service rates for small C&I customers have stabilized as the Company has recovered its undercollections. The undercollection for small C&I customers has been reduced to approximately \$1.4 million as of August 31, 2011. (See PPL Electric Hearing Exh. No. 1).

39. Each day, load is settled at PJM based on the prior day's load, but actual meter readings are not available in time for this "Settlement A". Meter reads for large customers are available and used for Settlement A, but for most residential and SC&I customers, the Settlement A load is estimated using load profiles for each rate schedule. (PPL Electric St. No. 2-R, p. 10).

40. After all meter reads are completed, and the data is verified, there is a second "Settlement B" that occurs 2 months later. This Settlement B load appears in the month it is completed, but actually is an adjustment for load that was scheduled 2 months prior. (PPL Electric St. No. 2-R, p. 10).

41. PPL Electric includes all billed default service revenue and incurred costs in its GSC and GSC-1 charges, and all such revenue and costs are audited regularly by Commission audit staff. (PPL Electric St. No. 2-RJ, p. 2; St. No. 1-RJ, pp. 4-5).

42. The Bureau of Audits already is on-site at PPL Electric, conducting an audit of PPL Electric's 2010 GSC and 2011 GSC-1. (PPL Electric St. No. 1-R, p. 11).

II. PROPOSED CONCLUSIONS OF LAW

PPL Electric Utilities Corporation (“PPL Electric” or the “Company”) proposes the following conclusions of law:

1. The Commission has jurisdiction over the subject matter and the parties to this proceeding. 66 Pa. C.S. §§ 501, et seq.

2. Tariffs that have been approved by the Commission have the force of law and are binding on both the utility and its customers. *Brockway Glass Co. v. Pa. P.U.C.*, 63 Pa. Cmwlth. 238, 437 A.2d 1067 (1981); *Behrend v. Bell Telephone Co.*, 242 Pa. Super. 47, 363 A.2d 1152 (1976).

3. The burden of proving that an existing tariff provision is unreasonable or discriminatory is on the complainant. *Paul Kossman t/a Kossman Dev. Co. v. Pa. P.U.C.*, 694 A.2d 1147 (Pa. Cmwlth. 1997). OSBA is the complainant in this proceeding and, therefore, bears the burden of proof.

4. Section 1307(e) provides for reconciliation of total revenues received with total expenses incurred. 66 Pa. C.S. § 1307(e)(1).

5. While the Commission is not bound by the rule of *stare decisis*, the Commission must render consistent opinions and should either follow, distinguish, or overrule its own precedent. *Bell Atl. v. Pa. P.U.C.*, 672 A.2d 352, (Pa. Cmwlth., 1995); citing *Pennsylvania Trust v. Dep’t of Env’tl. Prot.*, 863 A.2d 93, 107 (Pa. Cmwlth. 2004).

6. The OSBA has not presented sufficient justification for the Commission to overrule 30 years of practice and procedure in this proceeding.

7. Cash working capital is a cost element of providing default service. See 52 Pa. Code § 69.1808(a)(4).

8. Utilities are permitted to recover a cash working capital requirement in rates. See *Pennsylvania Power & Light Co. v. Commonwealth of Pa.*, 668 A.2d 620, 621 (Pa. Cmwlth. 1995).

9. The Commission has recognized that cash working capital is a cost element of providing default service. 52 Pa. Code § 69.1808(a)(4).

10. It is not reasonable to change the Company's reconciliation methodology before providing another mechanism for PPL Electric to recover its working capital allowance.

11. Unbilled revenues are not considered when forecasting test year revenues in a base rate proceeding. See e.g., *Pa. P.U.C. v. Metropolitan Edison Co.*, Docket No. R-00922314 et al, 1993 Pa. PUC LEXIS 41, *51-*55, Order entered January 21, 1993; *Pa. P.U.C. v. Western Pa. Water Co.*, Docket No. R-850096 et al, 1986 Pa. PUC LEXIS 147, 37-*38, Order entered January 29, 1986.

III. PROPOSED ORDERING PARAGRAPHS

PPL Electric Utilities Corporation (“PPL Electric” or the “Company”) proposes the following ordering paragraphs:

1. The OSBA’s request to include unbilled revenues in the Section 1307(e) reconciliation methodology is denied.

2. The OSBA’s request to require PPL Electric to refund E-factor collections, revenue under-reporting, and any excess costs is denied.

3. The OSBA’s request to direct the Bureau of Audits to conduct an audit of PPL Electric is denied.

4. The Complaint of the Office of Small Business Advocate is dismissed.

5. The Commission’s Secretary shall mark Docket No. C-2011-2245906 as closed.