

COMMONWEALTH OF PENNSYLVANIA



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January 17, 2014

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

RE: Pennsylvania Public Utility Commission,
et al. v. Duquesne Light Company
Docket No. R-2013-2372129

Dear Secretary Chiavetta:

Enclosed please find the Office of Consumer Advocate's Reply Brief in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully Submitted,

A handwritten signature in black ink that reads "David T. Evrard".

David T. Evrard
Assistant Consumer Advocate
PA Attorney I.D. # 33870

Enclosures

cc: Honorable Conrad A. Johnson
Certificate of Service

173469

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-2013-2372129
 Duquesne Light Company :

REPLY BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) filed its Main Brief on January 6, 2014. The OCA submits this Reply Brief in response to the Main Brief of Duquesne Light Company (DLC or the Company). In its Main Brief, DLC discussed the revenue requirement adjustments proposed by other parties to the case as a means of demonstrating that the revenue requirement settlement reached by all but one party was supported by substantial evidence. In addition, DLC noted that its discussion of other parties' revenue adjustments was not intended to argue that the revenue increase proposed under the settlement resulted in any specific return on equity or that any specific revenue adjustments were accepted or not accepted, but rather that the proposed black box revenue increase under the settlement is supported by substantial evidence. DLC M.B. at 24-25.

The OCA's Reply Brief is limited to addressing the Company's discussion of the merits of the OCA's revenue adjustments so that the record is clear as to the evidence adduced by the OCA in support of its adjustments. As the settlement is a "black box" settlement and no opposition has been raised to the revenue requirement, no determination of the individual adjustments will need to be made. The OCA, though, wants to ensure that the record is complete in light of the Company's Main Brief.

Settlements are encouraged by the Public Utility Commission. See, 52 Pa. Code §§ 5.231, 69.410. Often in rate cases, parties enter into "black box settlements." In a black box settlement, parties agree to a revenue requirement without addressing the individual revenue adjustments proposed by each party. Black box settlements are very useful because it is unlikely that the parties will be able to reach a consensus on every revenue adjustment proposed in the proceeding. By avoiding such disagreement, settlement is facilitated. In this proceeding all

active parties¹, with the exception of NRG, either agreed to enter into a black box settlement with a revenue requirement of \$48 million, or agreed not to oppose the settlement.

At the conclusion of the hearings, ALJ Conrad A. Johnson directed the parties to file Main Briefs on January 6, 2014, and set the filing date for the Settlement for January 17, 2014. At that time, no formal objection to the Settlement had been submitted, but it appeared that the NRG parties would oppose the Settlement based on NRG Counsel's cross-examination of OCA witness David J. Effron.² On January 6, 2014, DLC filed its Main Brief, which included Section III.A.2.c, a discussion of the merits of the OCA's revenue adjustments in the event that NRG opposed the revenue requirement reached in the Settlement. The OCA believes that because the parties, with the exception of NRG, settled on a revenue requirement, and the revenue requirement is not opposed, that the ALJ should not consider DLC's discussion on the merits of the OCA's revenue adjustments. The OCA submits that specific issues that are part of a black box settlement do not need to be addressed by an ALJ.³

Although the individual adjustments should not be considered, the OCA believes that it must provide complete information for the record on the OCA's adjustments. See, DLC I.B. at 24-34. Specifically, the OCA will provide information regarding the following adjustments discussed in DLC's Main Brief:

- Wages and salaries;
- Incentive Compensation;
- Uncollectible Accounts Expense;
- Professional Service Expense;
- Utility Costs;
- Mailing Costs; and

¹ The four customer complainants have not been active in this proceeding. The Company served a copy of the Settlement on the customer complainants on January 16, 2014.

² Tr. 218-228

³ By letter dated January 15, 2014, from Counsel for DLC to Judge Johnson, DLC withdrew all Proposed Findings of Fact from its Main Brief that bore on matters addressed by the Settlement.

- End of year rate base and annualization adjustment.

While the OCA agrees with the Company that some of the OCA's adjustments may not have been accepted, the OCA submits that all parties share this risk, and that the OCA adjustments are reasonable and well supported by evidence.

II. SUMMARY OF THE ARGUMENT

The OCA's revenue adjustments proposed in this proceeding are well supported by evidence.

III. ARGUMENT

A. Non-unanimous Settlement Issues

1. Standard of Review

No reply necessary.

2. Revenue Requirement

c. Expense Adjustments

iii. Wages and Salaries

As noted by DLC in its Initial Brief, the OCA proposed a number of adjustments to the Company's claim for wages and salaries expense. OCA St. No. 1 at 12-16; OCA St. No. 1-SR at 4-7. In total, the OCA's adjustments amounted to a reduction of \$4.784 million in wages and salaries expense on a jurisdictional basis. OCA St. 1-R, Sched. C-1. The OCA's adjustments included reducing the projected annual increase in wage rates from 3.4% to 3.0%, reducing the number of employees projected to be working in the Fully Projected Future Test Year (FPFTY), and limiting the amount of overtime costs projected for the FPFTY. With respect to the annual wage rate increase, OCA witness Effron testified that the wage rate increase in the Historic Test Year (HTY) was 3.0% and that while the Company was projecting increases of 3.4% for the

Future Test Year (FTY) and FPFTY, the Company had not provided any sound reason for the increase in wage rate escalation beyond that experienced in the HTY. OCA St. No. 1 at 13-14.

Regarding the size of the FPFTY employee complement, Mr. Effron noted that as of September 2013 DLC's actual number of employees had increased compared to the HTY, but not at the rate projected by the Company. Using the actual rate of increase as of September, Mr. Effron projected that the rate of increase in number of employees through the FPFTY would be slightly less than 5.5% when compared to the HTY. Therefore, for the purpose of determining the FPFTY payroll expense, Mr. Effron recommended that the increase in the number of employees from the HTY to the FPFTY be assumed to be no more than 5.5%. OCA St. No. 1 at 14-15. This would reduce the projected FPFTY employee complement from 1,363 to 1,324. DLC St. No. 2-R at 8; OCA St. No. 1-SR at 6.

With respect to overtime costs, Mr. Effron pointed out that in the Company's forecasts of payroll costs, overtime costs were increasing disproportionately compared to "normal" payroll costs. Mr. Effron maintained that to the extent the increases in overtime costs are incorporated into the forecasts, any such increase should be assumed to be no more than proportional to the increase in normal payroll costs. OCA St. No. 1 at 15.

OCA witness Effron also responded to each of DLC's criticisms of his Wages and Salaries adjustments presented in the Company's Rebuttal Testimony. See OCA St. No. 1-SR at 4-7.

The OCA proposed an additional adjustment related to miscellaneous employee benefits expense. OCA witness Effron noted a 55% increase between the HTY and the FPFTY in the Company's claim for this expense item. He went on to state that while these benefits could be expected to increase with the number of employees and wage rate increases, and while the level of these expenses would also be influenced by the upward trend in medical costs, an increase of

55% from the HTY to the FPFTY was not reasonable. Accordingly, Mr. Effron proposed a method for determining an appropriate level of FPFTY employee benefits expense based on the percentage increase in payroll expense, adjusted for the higher rate of increase in medical benefit costs. Using Mr. Effron's method resulted in a \$1.791 million reduction in the Company's claimed employee benefits cost. OCA St. No. 1 at 19-20.

In Rebuttal, DLC noted errors in the Company-supplied data requests relied upon by Mr. Effron to calculate his expense reduction. Using corrected information, the size of Mr. Effron's adjustment was lowered to \$918,000. Notwithstanding the reduction, the Company opposed the proposed adjustment arguing that the use of a percentage increase in payroll expense as a base to determine benefits expense was inappropriate and that the medical benefit cost adjustment Mr. Effron used was too small. DLC St. No. 2-R at 10-12.

In response to the Company, Mr. Effron continued to maintain that a reduction to employee benefits expense is appropriate. The OCA submits that it has adduced substantial evidence in support of its proposed adjustments.

iv. Incentive Compensation

In this case, the Mr. Effron proposed a \$1.054 million reduction to DLC's claim for incentive compensation. This adjustment is intended to bring the percentage increase in incentive compensation (from HTY to FPFTY) in line with the percentage increase in payroll expense. OCA St. No. 1 at 18-19; OCA St. No. 1-SR at 8-9 and Sched. C-1.1.

OCA witness Effron testified that the changes to the incentive compensation program were a means to increase overall compensation. By including the full amount of the increases in incentive compensation as an expense in the FPFTY, Mr. Effron pointed out that the Company is assuming the incentivized goals will be achieved and the compensation earned. He noted that if

it is truly an incentive-based program, it should not be assumed that all goals will be met and that the full amount of compensation will be paid.

Mr. Effron's adjustment is supported by substantial evidence.

v. Uncollectible Accounts Expense

As part of its claim for uncollectible accounts expense, DLC included a \$1.5 million "Annual Normalization Amount" consisting of two components: (1) a \$600,000 component related to a supposed increase in delinquencies in 2013 compared to the previous average five year balance; and (2) a \$900,000 component related to an increase in uncollectibles that the Company maintains will result from a three month moratorium on service terminations which will occur when the Company changes to its new customer billing and information system. The Company estimated that this increase in uncollectibles would total \$5.2 million and proposed to amortize it over five years. DLC Exh. 2, Sched. D-10. OCA St. No. 1 at 22-23. OCA witness Effron proposed eliminating the full Annual Normalization Amount from DLC's claim. OCA St. No. 1 at 22-24; OCA St. No. 1-SR at 11-13. With respect to the \$600,000 component, OCA witness Effron pointed out that based on more current data the estimated increase in delinquencies in 2013 appeared to be temporary as the balance of delinquencies in relation to the five year average decreased in each month after June, and as of September 2013, the balance of delinquencies was below the five year average. OCA St. No. 1 at 23.

With respect to the \$900,000 component, witness Effron characterized it as speculative. He noted that the Company had provided no information on how the increase of \$5,200,000 was arrived at nor had the Company explained why a moratorium related to the change to the new system would result in additional uncollectible accounts rather than just a delay in the collection of those accounts. OCA St. No. 1 at 23-24.

Through Surrebuttal testimony, Mr. Effron responded to the Company's Rebuttal testimony on this issue. OCA St. No. 1-SR at 11-13. The OCA has presented substantial evidence in support of its adjustment.

vi. Professional Service Expense

The OCA proposed a reduction of \$4.107 million to the DLC's claim for Professional Service Expense, the basis of which was that the Company had not properly allocated transmission-related vegetation management and other maintenance expense to the transmission function. OCA St. No. 1 at 27-30; OCA St. No. 1-SR at 14-18 and Sched. C-1.5. OCA witness Effron noted that the Company's method of allocating FPFTY Operating and Maintenance costs implicitly allocates a portion of the increase in transmission-related maintenance programs to the distribution function. This is because the Company does not forecast the FPFTY expenses by FERC account, but rather forecasts the FPFTY expenses by cost element and then allocates the expenses to FERC accounts based on the actual historic FERC account expenses. OCA St. No. 1 at 28-29. Mr. Effron pointed out that because the actual historic transmission expenses were low in relation to distribution expenses, the Company's method of forecasting by cost element and then allocating expenses based on historic FERC account expenses does not properly allocate (as between transmission and distribution) the increase in maintenance expenses from the HTY to the FPFTY. *Id.* at 29.

The Company opposed OCA's proposed reduction, pointing out that the overall percentage of expense allocated to the transmission function for the FPFTY is consistent with the prior four years. According to the Company, while this percentage changes somewhat from year to year, the split between transmission and distribution remains consistent over the period. The Company maintained that its method of allocation, which is ultimately based on historic

relationships, can create distortions by FERC account, but does not result in an overstatement of total distribution expense. DLC St. No. 5-R at 18.

In his Surrebuttal testimony, OCA witness Effron further explained his adjustment. He stated:

[T]he Company is clearly forecasting substantial increases to transmission vegetation management and other transmission maintenance expenses from the HTY to the FPFTY. These increases are *disproportional* to the historical transmission maintenance expenses and, more importantly, to the total transmission O&M expenses incurred in the HTY and in other recent years. If anything, Exhibit RLO-3 demonstrates that that the Company's method of allocating FPFTY cost elements to FERC accounts has not properly captured the disproportionate increases in transmission vegetation management and other transmission maintenance expenses. That is, given the magnitude of increases in expenses that are directly assignable to the transmission function in the FPFTY, the ratio of transmission expenses to total expenses in the FPFTY should logically *increase* from the historic ratio, not remain the same.

OCA St. No. 1-SR at 16-17.

The OCA submits that it has adduced substantial evidence in support of its adjustment. That said, the OCA notes that with respect to vegetation management expenses, which represent a substantial portion of DLC's claim for professional service expense, the parties have agreed to a Settlement term which commits DLC to spend \$15 million on distribution vegetation management for each of three years beginning May 1, 2014. Joint Petition for Approval of Non-Unanimous Settlement, ¶ 34.

vii. Utilities Expense

The OCA proposed a \$696,000 reduction in DLC's utilities expense for the FPFTY on the ground that the Company had not adequately justified the increase in this expense category from the HTY (\$1,617,000) to the FPFTY (\$2,313,000), an increase of 43%. Accordingly, the

OCA recommended maintaining the expense at the HTY level. OCA St. No. 1 at 30-31; OCA St. No. 1-SR at 18 and Sched. C-1.5.

The Company objected to this adjustment noting that the amount spent on utilities in the HTY was atypically low due to mild weather and lower energy prices. The Company noted higher utilities expense in years 2009, 2010 and 2011, albeit a downward trend. The Company maintained that utilities expense should be forecast on a weather normalized basis factoring in forward energy prices. DLC St. No. 2-R at 15.

In response, OCA witness Effron addressed the Company's comparison of the HTY level of expense with that in prior years:

It is true that the utilities expenses incurred in those years were higher than the expense in the HTY. However, Mr. Ankrum provides no evidence that the decrease in expense from those years to the HTY is actually being reversed and that the expense is returning to the higher levels in the earlier years. Mr. Ankrum attributes the lower expense in the HTY to milder weather and lower energy prices, but he provides no analysis of how those factors affected the HTY utilities expense, nor does he show how the Company's projections of future energy prices result in its FPFTY utilities expense.

OCA St. No. 1-SR at 18. The OCA has presented substantial evidence in support of its adjustment.

viii. Mailing Costs

The OCA proposed a reduction to DLC's claim for mailing costs of \$998,000. The basis for this adjustment was that the Company had not adequately justified the substantial increase in mailing costs from the level in the HTY (\$6,000) to the level projected for the FPFTY (\$1,004,000). The OCA proposed to eliminate the entire increase. OCA St. No. 1 at 31-32; OCA St. No. 1-SR at 19 and Sched. C-1.5. OCA witness Effron further testified that the Company provided no quantification of the costs of the new mailings and no documentation or calculations supporting the increased cost of nearly \$1 million. OCA St. No. 1-SR at 19.

Accordingly, the OCA submits that it has proffered substantial evidence in support of the adjustment.

ix. End of Year Rate Base and Annualization Adjustments

For purposes of determining the value of its rate base for the FPFTY, DLC proposed to use the end of test year balances for all but three components of its rate base (cash working capital, materials and supplies and customer deposits). OCA St. No. 1 at 4. The OCA proposed, instead, that the Company be required to use the average value of its rate base for the FPFTY for purposes of setting rates. OCA St. No. 1 at 5-9; OCA St. No. 1-SR at 2-3. The OCA's proposal would reduce the value of DLC's rate base by approximately \$10 million. OCA St. No. 1-SR, Sched. B-1. The OCA also recommended eliminating the Company's proposed annualization adjustments related to revenues, wages and salaries, payroll taxes and depreciation. OCA St. No. 1 at 10, 16-17, 32, and 33.

OCA witness Effron explained why the advent of the FPFTY changed the rationale for using end of test year rate base as was common when Pennsylvania used an FTY. He stated:

...[T]he theory supporting the use of an end of test year rate base in the context of an HTY or FTY (which ends *prior to* or at approximately the same time that the new rates go into effect) is that the rate base as of the end of the test year is more representative of the investment that the utility will have in its rate base at the time that the rates being set go into effect. With an FPFTY, the average rate base represents investment that the utility will have during the rate year. The theory supporting use of a year end rate base in the context of an HTY or FTY does not justify the use of year end rate base in a fully projected future test year that coincides with the rate year. The FPFTY is not the same as an FTY, and the justification for the use of a year end rate base in the context of an FTY does not apply to an FPFTY.

OCA St. No. 1-SR at 3.

The OCA submits that it has produced substantial evidence as to its adjustment.

1. Revenue Allocation

No reply necessary.

2. Universal Service

No reply necessary.

3. Customer service

No reply necessary.

4. LED Street Light Program

No reply necessary.

A. Rider No. 18 Issues

No reply necessary.

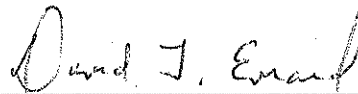
B. Miscellaneous Issues

No reply necessary.

IV. CONCLUSION

The OCA submits that because a Settlement on the issue of revenue requirement has been reached and not contested by any active party in this proceeding, the ALJ does not need to consider the merits of any party's proposed revenue adjustments. The OCA provides this discussion of the adjustments in this Reply Brief in response to DLC's Main Brief so that the record is complete.

Respectfully Submitted,



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January 17, 2014

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CERTIFICATE OF SERVICE

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Docket No. R-2013-2372129

I hereby certify that I have this day served a true copy of the foregoing document, the Office of Consumer Advocate's Reply Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code Section 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 17th day of January 2014.

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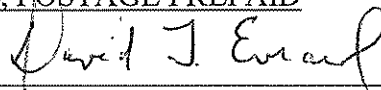
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