



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Office of Administrative Law Judge

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November 9, 2004

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Linda Miller, Coordinator
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Re: Pennsylvania Public Utility Commission, et al. v. PPL Electric Utilities Corporation
Docket No. R-00049255

Dear Linda Miller:

This is an overdue letter of appreciation dating back to July 19, 2004. Thank you for the support you gave to the Public Utility Commission when it held two sessions of public input hearings in your facility on that date. You and your staff were courteous at all times, and available until the close of the second session in the evening. The rooms were comfortable and well set up, and the fact that water was available was a benefit to witnesses and attorneys alike.

Thank you again for providing a fine public input hearing facility.

Very truly yours,

Allison K. Turner
Administrative Law Judge

cc: Susan Licon, Scheduling Officer
Elizabeth Plantz
Secretary's Bureau

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November 10, 2004

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By Hand Delivery

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Pennsylvania PUC v. PPL Electric Utilities Corporation
Docket No. R-00049255

Dear Mr. McNulty:

Enclosed please find an original and nine copies of the Exceptions of the PennFuture Parties along with a Notice of Change of Address in the above-captioned matter. Copies have been served upon all parties of record as indicated on the attached Certificate of Service.

If you have any questions, please contact me at (215) 545-9693.

Sincerely,

Charles McPhedran
Senior Attorney

DOCUMENT

cc: Hon. Allison Turner
Hon. Susan D. Colwell
Hon. Ember S. Jandebaur

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

PPL Electric Utilities Corporation

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Docket No. R-00049255

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EXCEPTIONS OF THE PENNFUTURE PARTIES

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Date: November 10, 2004

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I. Introduction

On October 22, 2004, Administrative Law Judge Allison K. Turner issued a Recommended Decision (RD) in this proceeding, which involves a request for approval of an overall annual net increase in distribution revenues by PPL Electric Utilities Corporation (PPL or PPLEU). In the Recommended Decision, Judge Turner recommended continued funding for the Sustainable Energy Fund (SEF), with consideration by the Commission of declining amounts of funding. RD at 87-88.

Citizens for Pennsylvania's Future (PennFuture) filed a Petition to Intervene on behalf of PennFuture, Char Magaro, and Edward M. McGovern (collectively, the PennFuture Parties) on May 18, 2004, which was granted on June 21, 2004 (Prehearing Order No. 3 at 8; see also RD at 2). Under 52 Pa. Code § 5.533, the PennFuture Parties hereby file Exceptions to the Recommended Decision on issues relating to SEF.

II. Background

The Recommended Decision describes the origins of the Sustainable Energy Fund in Paragraph E.5. of the Joint Petition for Full Settlement of PP&L, Inc.'s Restructuring Plan and Related Court Proceedings. RD at 77. This provision described SEF and its purposes:

E.5. Sustainable Energy Fund. PPL will establish a sustainable energy fund which shall be funded from the 1.74 cents per KWH transmission and distribution rate at .01 cents per KWH (less applicable gross receipts tax) on all power sold for all customers beginning on January 1, 1999 and ending on December 31, 2004, or until the Commission establishes new distribution rates, whichever is longer. The .01 cent per KWH shall not automatically be considered a cost of service element upon expiration of the transmission and distribution rate cap on December 31, 2004. The purpose of the fund is to promote the development and use of renewable energy and clean energy technologies, energy conservation and efficiency which promote clean energy.

Joint Petition for Full Settlement of PPL, Inc.'s Restructuring Plan and Related Court Proceedings, Docket No. R-00973954 (1998), Paragraph E.5; RD at 77-78. In the current proceeding, PPL has recommended continued funding of SEF at current levels of 0.01 cents per kWh. PPL Statement No. 7 at 24-25; RD at 78. Some other parties also support continued funding. See, e.g., SEF Statement No. 1 at 22, SEF Main Brief (MB) at 14-16; Commission on Economic Opportunity (CEO) Statement No. 2 at 16, CEO MB at 19. Other parties proposed terminating SEF funding. RD at 80.

Evidence presented in this proceeding provided detailed information about SEF's mission, projects, and benefits to ratepayers. In its testimony, SEF described its mission thus:

...to promote, research, and invest in clean and renewable energy technologies, energy conservation, energy efficiency, and sustainable energy enterprises that provide opportunities and benefits for PPL ratepayers.

SEF Statement No. 1 at 3; SEF MB at 5. To accomplish this mission, SEF provides loans and grants in an entrepreneurial fashion to clean energy projects, many of which have distribution benefits, within the PPL service territory (SEF Statement No. 1 at 3-4, 13). In its annual report for 2002-03, SEF provided many examples of these projects, including installations of photovoltaic systems, the use of energy-saving technology, the construction of energy-efficient buildings, and the development of wind farms. SEF Statement No. 1, Attachment A at 10-12; SEF MB at 7-13; see also PPL Statement No. 7, Exhibit TRD-3.

Testimony offered in this proceeding also described the benefits of SEF's work to distribution ratepayers. Energy efficiency, demand management and conservation relieve load and congestion on the distribution system, "extending its life and ending or delaying

the need for expensive distribution system upgrades." SEF Statement No. 1 at 13-14; SEF MB at 20. Distributed generation projects supported by SEF similarly reduce stress on the distribution system, relieving the need to expand or improve distribution and producing "a reliability and distribution cost of service benefit to all customers." PennFuture Parties Statement No. 1-R at 2-3, PennFuture MB at 3; see also SEF Statement No. 1 at 16-17 and PPL Statement No. 7-R at 36. Further, renewable energy and energy efficiency provide utility and ratepayer benefits as part of a balanced energy supply that provides a hedge against fluctuations in natural gas prices or the market price of electricity. PennFuture Parties Statement No. 1 at 6; PennFuture MB at 3.

In this proceeding, the PennFuture Parties urged a doubling in funding to 0.2 mills, or 0.02 cents per kWh, for two reasons. First, according to testimony submitted by the PennFuture Parties, at current levels of funding, SEF is unable to support many worthy projects. PennFuture Parties Statement No. 1 at 3, PennFuture MB at 3-4. For example, SEF could establish ongoing programs to provide grants, low interest loans, or performance subsidies for installing fuel cells, small wind turbines, or solar panels. SEF could continue its crucial role in developing the Pennsylvania wind industry, now the strongest in the East thanks in part to SEF's past support. SEF could make further investments in new renewable energy and energy efficiency programs. PennFuture Parties Statement No. 1 at 3, PennFuture MB at 4. SEF itself provides a list of projects that it could pursue with increased funding, including fuel cells, wind farm development, and long-term loans. SEF Statement No. 1 at 23, SEF MB at 27. Second, testimony submitted by SEF demonstrates that current funding for SEF is significantly lower than the rates of support provided to clean energy funds in other states, as demonstrated by a

comparison chart submitted by SEF in this proceeding. SEF Statement No. 1, Attachment C.

The Recommended Decision reviewed the history and purposes of SEF, its project evaluation methods, and examples of SEF projects. RD at 77-85. Finding that "the Commission has long recognized that reductions in demand and energy efficiency benefits customers, and has encouraged EDCs [electric distribution companies] to establish programs that pursue these goals," the Administrative Law Judge "posits that there should be a place and a role for organizations like SEF in the new market place, to market efficiency and demand reductions to all EDCs; not only PPLEU." RD at 87. Finding evidence of both successes and mistakes in SEF projects, the Recommended Decision reaches the following conclusion on SEF Funding:

Therefore, the ALJ recommends that the Commission approve funding of SEF as part of PPLEU's rates in the proceeding. However, consideration could be given to setting declining amounts, so that at the end of 5 years, or by December 31, 2009, funding will have ended.

RD at 87-88.

The Recommended Decision also mentions the issue of governance of SEF raised by one party to the proceedings (RD at 81) and notes PPL's position on the issue: that any Commission concerns about project management and evaluation, project selection, or governance could be the subject of a separate proceeding instead of impacting SEF funding in the current proceeding. RD at 88.

III. Exceptions

Exception No. 1: The Recommended Decision improperly ignored evidence about levels of funding for renewable energy in other states. RD at 77-88; PF MB at 4.

As noted above, parties in this proceeding offered evidence in support of a doubling in funding for SEF in this proceeding. For example, evidence in this proceeding demonstrated that current funding for SEF is significantly lower than the rates of support provided to clean energy funds in other states. SEF Statement No. 1, Attachment C. The average rate of support for these state funds is 1.3 mills, and the dollar-weighted average is over 2.0 mills. Doubling the rate of funding for SEF to 0.2 mills would still leave SEF funded at less than one-sixth of the average for its peers and less than one-tenth of the weighted average. PennFuture MB at 4, citing PennFuture Parties Statement No. 1 at 4. The Recommended Decision's failure to double funding for SEF impairs Pennsylvania's ability to compete with other states for renewable energy investment and thereby undermines the efforts of the Rendell Administration to attract such investment.

At no point in its discussion of SEF issues does the Recommended Decision consider evidence of funding in other states, evidence that was submitted by two parties on an issue central to the evaluation of SEF funding. The Recommended Decision makes no finding either accepting or discounting this evidence. Therefore, the Recommended Decision provides no basis for the Commission to consider the impact of much higher levels of funding for renewable energy in other states on funding for SEF. The PennFuture Parties urge the Commission to review the evidence on this issue appearing in the record at SEF Statement No. 1, Attachment C, which supports our claim for

increased funding for SEF that will help Pennsylvania compete for renewable energy investment.

Exception No. 2: The Recommended Decision provides no basis for its conclusion that the PUC should consider declining amounts of funding for the SEF. RD at 87-88.

The Recommended Decision contains a discussion of various aspects of SEF's purposes, budget, and projects, concluding with a recommendation that the Commission approve SEF funding but noting that "consideration could be given to setting declining amounts, so that at the end of 5 years, or by December 31, 2009, funding will have ended." RD at 88.

In contrast to the record-based discussion of some other SEF issues in the Recommended Decision, this conclusion offers no basis for the Commission to set the suggested "declining amounts" nor an explanation of why declining funding is appropriate. Indeed, just a few paragraphs before, the Recommended Decision held that "there should be a place and a role for organizations like SEF in the new market place, to market efficiency and demand reductions to all EDCs, not only PPLEU." RD at 87. Declining funding is not conducive to helping SEF find this place and role, and would seriously impair its ability to pursue its mission. As the Recommended Decision offers no evidence in support of this "consideration", the PennFuture Parties urge the Commission to reject it.

Exception No. 3: The Recommended Decision should resolve issues of governance raised in the proceeding. RD at 87-88; PF MB at 9-10.

The Recommended Decision notes the issue of SEF governance raised by the Office of Small Business Advocate (RD 81-82) and the following recommendation by PPLEU on governance issues:

To the extent the Commission has concerns regarding issue of program management and evaluation, project selection, or governance, the Commission can initiate a separate proceeding [or establish a collaborative] to address those concerns instead of eliminating SEF funding in this proceeding.

RD at 88, citing PPLEU Statement No. 7-R at 42, PPLEU MB at 156. Other parties also submitted testimony on issues of SEF governance. See, e.g., PennFuture Parties Statement No. 1-R at 6-7, PennFuture MB at 8-10; SEF Statement No. 1 at 31-33. However, the Recommended Decision does not appear to resolve the issue of governance.

As noted in our testimony and Main Brief, the PennFuture Parties believe that the SEF Board of Directors should include the most qualified candidates without strict requirements of stakeholder representation. This approach is consistent with draft best practices regarding nomination, election, and approval of directors of sustainable energy funds under consideration by the Pennsylvania Sustainable Energy Board and the Commission. PennFuture Parties Statement No. 1-R at 7; Main Brief at 9-10. Therefore, we urge the Commission to require that SEF follow this approach immediately.

IV. Conclusion

For the reasons set forth herein, in our Main Brief and Reply Brief, and based on evidence admitted at the evidentiary hearing in this matter, the PennFuture Parties urge the Commission:

- to double funding for SEF to provide increased benefits to ratepayers;
- not to consider declining levels of funding for SEF;
- to include the most qualified candidates on SEF's Board of Directors without regard to stakeholder representation.

For the reasons set forth herein, the PennFuture Parties except to all findings to the contrary in the Recommended Decision.

Respectfully submitted,



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Dated: 11/10/04

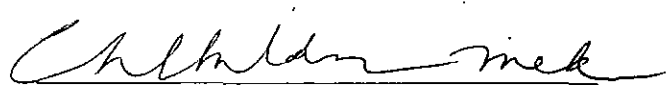
CERTIFICATE OF SERVICE

PA PUC v. PPL Electric Utilities Co.

Docket No. R-00049255

I hereby certify that I have this day served a true copy of the Exceptions of the PennFuture Parties and Notice of Change of Address upon the participants, listed below, in accordance with the requirements of § 1.54 (relating to service by a participant).

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November 11, 2004

Mr. James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, Second Floor
Harrisburg, PA 17105

via **FEDERAL EXPRESS**
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NOV 11 2004

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

RE: PP&L Electric Utilities - Request for Rate Increase
Docket No. R-00049255

Dear Secretary McNulty:

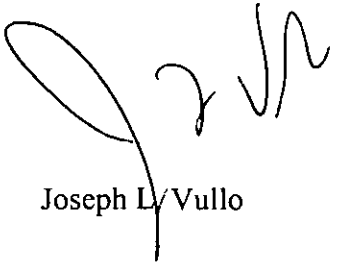
Enclosed please find an original and nine (9) copies of Exceptions of CEO to the Recommended Decision issued in the above-referenced matter.

By overnight mail, I am providing a copy of the same, along with a computer disk containing the Exceptions to the Office of Special Assistants.

In addition, I have provided all parties of record by electronic submission with a copy of the Exceptions and have followed up that with a hard copy to all parties.

If you need anything further from my office, please do not hesitate to contact me.

Respectfully submitted,



Joseph L. Vullo

JLV/jar
encls.

cc: Office of Special Assistants (via Federal Express)
All Parties of Record

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COMMISSION

NOV 11 2004

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

v.

R-00049255

PP&L ELECTRIC UTILITIES

Request for a Rate Increase

**EXCEPTIONS OF COMMISSION ON ECONOMIC OPPORTUNITY
TO RECOMMENDED DECISION**

NOW COMES, the Commission on Economic Opportunity (CEO) by and through counsel, Joseph L. Vullo, Esquire, and files Exceptions to the Recommended Decision of ALJ Allison K. Turner dated October 21, 2004 in the above-captioned matter and sets forth the following:

INTRODUCTION

1. CEO is a non-profit organization serving the low income and elderly in Luzerne County, Pennsylvania.
2. CEO intervened in the above-captioned matter to address the Company's universal service programs.
3. CEO files these Exceptions because the ALJ's Recommended Decision presents issues of first impression regarding what are "appropriately funded and available" universal service programs as required under the Electric Choice Act.

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EXCEPTIONS

1. **THE ALJ ABUSED HER DISCRETION AND COMMITTED AN ERROR OF LAW BY NOT REQUIRING THAT THE COMPANY'S ON-TRACK PROGRAM BE "APPROPRIATELY FUNDED AND AVAILABLE".**

The ALJ failed to adequately address the June 12, 2003 Order of the PUC in which the PUC found that PP&L's universal service program was not appropriately funded or available as required by the Electric Choice Act. In that June 2003 Order, the PUC ordered that PP&L serve at a minimum 15,000 to 17,000 low income customers in its On-Track program. PP&L's proposal in this proceeding would not meet that 15,000 to 17,000 participation until the year 2007. The ALJ abused her discretion and committed an error of law when she ignored the June 2003 Order of this Commission and allowed PP&L's inadequate proposal. CEO files an exception to the portion of the ALJ's Recommended Decision in which she allowed PP&L's inadequate proposal which is contained in her Recommended Decision at pages 163 through 165.

One part of the Company's universal service program is On-Track. On Track is the Company's customer assistance program whereby low income customers with overdue balances, who enroll in the program, are offered a reduced monthly payment and arrearage forgiveness. (Dahl Direct, PP&L Statement No. 7, Exhibit TRD-1). The Company proposed to increase funding for its On-Track program in this proceeding. For the current year, PP&L estimates that it will spend approximately \$11.7 million for On-Track. (Dahl Direct, PP&L Statement No. 7, p. 6). Although it proposes

to increase On-Track spending to \$14.7 million, that level of spending will not be attained until the year 2007. (N.H.T., p. 726).

PP&L has offered in its direct testimony through witness Timothy R. Dahl that the On-Track annual spending level of \$14.7 million would allow it to enroll 15,000 to 17,000 customers in its On-Track program. Mr. Dahl conceded at the hearing held in this matter that the goal of 15,000 to 17,000 customers would not be attainable until the year 2007 when the funding level reaches \$14.7 million (N.H.T., p 726).

PPL's proposed On-Track funding and enrollment goals completely fail to address the finding of the PUC in its June, 2003 Order that the Company's On-Track program is not appropriately funded or available. In that June, 2003 Order, the PUC rejected the Company's proposal regarding the number of potential participants in its On-Track Program and stated as follows:

"The Commission determines that, based on consideration of the all of the data and reports, an appropriate enrollment number should be no lower than the 17,000 enrollment slots approved by the Commission in 2000 when there was 75,000 overdue low income customers, and possibly as high as 30,000, the number of enrollment slots recommended in the independent third-party evaluation report submitted pursuant to 52 Pa. Code §54.74."

June 12, 2003 Order, Docket No. R-00031398, CEO Cross Exam, Exhibit No. 1, p. 15.

The Company does not dispute that the estimated population for enrollment into On-Track is 30,000 customers. (Dahl Rebuttal Testimony, PPL Statement No. 7-R, p. 14).

The current proceeding is not the first time that the Company proposed to enroll a maximum of 17,000 customers in its On-Track program. The June, 2003 Order notes that the Company's year 2000 Universal Service Plan sought to enroll a maximum of 17,000 customers in On-Track over the three year period covered by the plan. Despite that proposal made by the Company in the year 2000, it had only 10,000 active customers in the On-Track program as of the end of 2002, achieving only 59% of its target enrollment of 17,000. (June Order, p. 4). In short, the Company, since the year 2000 has continually proposed enrolling 17,000 customers in its On-Track program and has consistently failed to meet that goal and now only proposes to serve 15,000 to 17,000 customers by the year 2007. The Company is proposing in this proceeding what the PUC found to be "inappropriately funded" in June of 2003. The Company and the ALJ have completely ignored the June, 2003 Order in this proceeding by proposing, and accepting, to meet the target enrollment of 15,000 to 17,000 only by the year 2007. In short, PPL proposed to spend for its On-Track program, and the ALJ accepted, what the PUC found to be inappropriate in its June, 2003 Order and does not propose to meet the absolute minimum suggested by the PUC, 17,000 enrollees, until the year 2007. It is difficult to determine how the Company's proposal in this proceeding can be considered "appropriately funded or available" and the PUC's June, 2003 Order should be given great deference and followed. The Commonwealth Court in George v. PUC, 735 A.2d 1282 (Cw. 1999) declared that the PUC, as the agency charged with

implementing the Electric Choice Act, should not be overruled unless it is clearly erroneous.

As indicated above, the PUC found in its June, 2003 Order that the Company's participation rate for its On-Track Program was 8%, the lowest of all major electric distribution companies in Pennsylvania. (June Order, p. 4). Mr. Dahl conceded at hearing that "participation rate" is calculated by dividing the number of participants enrolled as of December 31 of a program year by the number of confirmed low income customers. (N.H.T., p. 723). Mr. Dahl also conceded that the Company serves approximately 200,000 low income customers in its service territory. (N.H.T., pp. 723-724). Based upon the number of low income customers, the Company's participation rate would actually decrease to 7.5% when it reaches maximum funding level for On-Track in the year 2007. The Company proposes to enroll a minimum of 15,000 customers in the year 2007 when it reaches maximum funding of \$14.7 million and based upon 200,000 low income customers the participation rate would drop below the 8% found to be inappropriate by the PUC in its June, 2003 Order. Even under the upper range of its proposed 2007 enrollment (17,000 customers), the participation rate in the Company's On-Track program would increase only to 8.5%.

In 1996, the Electricity Generation Customer Choice and Competition Act (Electric Choice Act) was enacted. 66 Pa.C.S.A. §2801, et seq. In its Declaration of Policy, the Act provides that:

"The Commonwealth must, at a minimum, continue the protections, policies and services that now assist customers who are low income to afford electric service."

Section 2802(10).

The Declaration of Policy further provided that:

"There are certain public purpose costs, including programs for low income assistance, energy conservation and others, which have been implemented and supported by public utilities' bundled rates. The public purpose is to be promoted by continuing universal service and energy conservation policies, protections and services, and full recovery of such costs is to be permitted through a nonbypassable rate mechanism."

Section 2803(17).

The Electric Choice Act mandated that the Public Utility Commission regulate universal service and energy conservation policies by stating the following:

"The commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution territory. Policies, activities and services under this paragraph shall be funded in each electric distribution territory by nonbypassable, competitively-neutral cost recovery mechanisms that fully recover the costs of universal service and energy conservation services. The commission shall encourage the use of community-based organizations that have the necessary technical and administrative experience to be the direct providers of services or programs which reduce energy consumption or otherwise assist low income customers to afford electric service. Programs under this paragraph shall be subject to the administrative oversight of the commission which will ensure that the programs are operated in a cost-effective manner."

Section 2804(9).

The Act defines "universal service and energy conservation" as follows:

"Policies, protections and services that help low income customers to maintain electric service. The term includes customer assistance programs, termination of service protection and policies and services that help low income customers to reduce or manage energy consumption in a cost effective manner, such as low income usage reduction programs, application of renewable resources and customer education."

Section 2803.

In its June 12, 2003 Order (Docket No. R-00031698), the PUC found that "...PPL's universal service plan does not appear to be either appropriately funded or available in its service territory as required at 66 Pa.C.S. §2804(9)." (June 12, 2003 Order, CEO Cross-Exam Exhibit No. 1, p. 3). The PUC based its conclusion that PPL's universal service programs were in violation of the Electric Choice Act based upon submissions made by PPL in addition to an evaluation completed by an independent program evaluator, RETEC. The finding that PPL's universal service programs were inappropriately funded and not available was also based upon an analysis by the PUC's Bureau of Consumer Services (BCS) of the data submitted by the Company and RETEC. A summary of the PUC's findings in that June 2003 Order are as follows:

1. The participation rate of customers in PPL's On-Track program (customer assistance program) was the lowest of all major electric distribution companies in the Commonwealth;
2. Despite the data supporting the fact that more PPL low income customers are payment troubled and need assistance to afford electric service, PPL

proposed to enroll fewer customers in its On-Track program than it proposed three years earlier in its 2000 Universal Service Plan;

3. PPL's call center does not make appropriate referrals to customers who are eligible for On-Track;

4. PPL's annual administrative costs per On-Track participant are \$225.00 compared to the industry average of \$128.00;

5. PPL's eligibility requirement for On-Track that a customer have an overdue balance of at least \$150.00 is inconsistent with the definition of a low income, payment troubled customer at 52 Pa. Code §54.72.

Despite the above findings, and despite the fact that PPL proposed to spend what the PUC found to be deficient in June of 2003, the ALJ allowed PPL's proposal even though that proposal is inappropriately funded and available in violation of the Electric Choice Act.

2. THE ALJ ABUSED HER DISCRETION AND COMMITTED AN ERROR OF LAW IN ALLOWING THE COMPANY TO IMPOSE A \$150.00 ARREARAGE REQUIREMENT BEFORE ENTRY INTO ITS ON-TRACK PROGRAM.

CEO files an exception to the ALJ's finding of fact and conclusion of law that the Company's \$150.00 arrearage eligibility requirement is allowable under the applicable regulations. Said finding of fact and conclusion of law is contained at pages 167 through 168 of the ALJ's Recommended Decision.

To be eligible for the Company's On-Track program, a low income customer must have an overdue balance of at least \$150.00. (Dahl Direct, PPL

Statement No. 7, Exhibit TRD1). The Company imposes this requirement despite the fact that it has been unable to enroll the 17,000 customers into its On-Track program since it established that figure as a goal in its 2000 Universal Service Plan.

The Company imposes this requirement despite the fact that the PUC in its June, 2003 Order found that the Company has the lowest participation rate of all major electric distribution companies in Pennsylvania and that the number of PPL accounts with overdue balances increased 43% from 75,000 accounts in the year 2000 to 107,386 accounts in the year 2002. (June, 2003 Order, pp. 4-5).

Most importantly, the PUC found in its June, 2003 Order that the arrearage requirement imposed by the Company is inconsistent with and in violation of the definition of a "low income, payment troubled customer" found at 52 Pa. Code §54.72. The PUC determined that the definition of a low income, payment troubled customer superceded the definition and eligibility requirements found in the CAP Policy Statement at 52 Pa. Code §69.262 (Definition) and §69.265(4)(i)-(iii) (Eligibility). (June, 2003 Order, p. 17). In addressing the Company's \$150.00 arrearage requirement, the PUC stated as follows:

"It is the Commission's desire to standardize customer assistance programs as much as practical, especially for eligibility criteria. Eligibility criteria for enrollment in a CAP should be standard no matter where a customer lives in Pennsylvania. However, until PPL's funding constraints are resolved, the Commission approves the retention of these additional eligibility criteria. When the funding issue is resolved, PPL shall revise its eligibility criteria to be consistent with [the] definition of low income, payment troubled customer at 52 Pa. Code §54.72." (June, 2003 Order, p. 11).

The CAP Policy Statement allowed a utility different choices in determining whether an applicant was a "low income, payment troubled customer." The CAP Policy Statement at 52 Pa. Code §69.265(4)(iii)(A)-(D), allowed a utility choices in how it determined whether an applicant was a low income, payment troubled customer and one of those choices was based upon whether the household had an arrearage. The CAP Policy Statement allowed the utility to define the amount of that arrearage. The PUC in the June, 2003 Order found that the definition of a low income, payment troubled customer set forth in Chapter 69 superceded the definition contained in the CAP Policy Statement which was being used by the Company to justify its arrearage requirement. The PUC in its June, 2003 Order required that the eligibility requirement, the \$150.00 arrearage, be changed when the Company's funding issue was resolved. This proceeding will resolve the Company's funding issue for its On-Track program and therefore that eligibility requirement, because it is inconsistent with the regulations contained in Chapter 69, is required to be abolished. Again, the ALJ ignored the mandate of the PUC in its June, 2003 Order in which it required that the Company discontinue its \$150.00 arrearage requirement for its On-Track program.

3. THE ALJ ABUSED HER DISCRETION AND COMMITTED AN ERROR OF LAW BY ALLOWING THE COMPANY TO INEQUITABLY DISTRIBUTE ITS HARDSHIP FUND THROUGHOUT THE COMMONWEALTH.

CEO files an exception to the ALJ's determination that the Company should be allowed to distribute its hardship funds inequitably throughout the

Commonwealth. The ALJ's findings of fact and conclusions of law relative to this issue are contained at pages 171 through 172 of her Recommended Decision.

The Company's Operation HELP is a hardship fund designed to help low income customers in paying their electric bills. Discovery responses from the Company indicated that HELP dollars are not equitably distributed throughout PPL's service territory. CEO witness Brady addressed those discovery responses and found that Luzerne County contained 9.8% of the Company's low income customers but received only 5.5% of total HELP dollars in 2003. (Brady Direct, CEO Statement No. 1, p. 8). Because the purpose of HELP dollars is to help low income customers, CEO proposed in this proceeding that HELP dollars be distributed equitably throughout PPL's service territory based upon the percentage of low income customers in each County within the territory. PPL resisted this request but offered little justification for its resistance. PPL witness Dahl stated in his rebuttal testimony that HELP dollars are allocated based upon "low income population, expenditure trends of the administering agencies and overall customer needs in the various operating areas." (Dah Rebuttal Testimony, PPL Statement No. 7-R, p. 31). The three factors listed by Mr. Dahl in effect are all related to customer needs and because the HELP program is designed to help low income customers, it would make perfect sense for HELP dollars to be allocated based upon the percentage of low income customers in each of the Counties within PPL's service territory.

4. THE ALJ ABUSED HER DISCRETION AND COMMITTED AN ERROR OF LAW WHEN SHE FAILED TO REQUIRE THAT THE COMPANY EXPEND A SUFFICIENT AMOUNT OF FUNDS ON SOLAR HOT WATER APPLICATIONS.

CEO files an exception to the ALJ's Recommended Decision to reject CEO's proposal to increase the amount of funding for solar hot water applications contained at pages 166 through 167 of the Recommended Decision.

The Company's WRAP, or Winter Relief Assistance Program, is offered to low income customers whereby those customers receive free measures and services designed to reduce energy consumption. (Dahl Direct, PPL Exhibit TRD1). In this proceeding, PPL proposed to increase WRAP spending from \$5.7 million annually to \$6.7 million annually. (Dahl Direct, PPL Statement No. 7, p. 12, N.H.T., p. 734). However, PPL proposed to ramp up that increase and will not reach the \$6.7 million figure until 2007. Of that \$6.7 million annual spending for WRAP, PPL intends to allocate \$600,000 to solar hot water heating installations. Again, PPL intends to ramp up spending for solar hot water applications by spending \$325,000 in 2005, \$475,000 in 2006 and will not reach the proposed spending level of \$600,000 until 2007. (N.H.T., p. 734). Despite its proposal to ramp up spending for WRAP and the solar hot water application component of WRAP, PPL proposes to collect immediately from residential customers for the increased spending levels that will not be reached until 2007. (Dahl Direct, PPL Statement No. 7, p. 8).

CEO has proposed through its witness John Howatt that PPL increase WRAP spending immediately to \$7 million annually of which \$1 million be allocated for

solar hot water applications. (Howatt Direct, CEO Statement No. 2, p. 23). CEO's proposal is based upon Mr. Howatt's testimony that:

"Low income energy efficiency and access to sustainable energy resources constitute the cornerstone of long-term low income energy security. A rapid new infusion of efficiency and renewable energy resources are necessary to protect low income households from the effects of rising and volatile prices that appear likely in the new era of electric utility industry restructuring."

(Howatt Direct, CEO Statement No. 2, p. 14).

Mr. Howatt points to the success of PPL's low income renewable energy pilot program which came out of its restructuring for support of CEO's recommendation that \$1 million of annual WRAP funding be devoted to solar hot water installations. As indicated above, the Electric Choice Act clearly charges the PUC with ensuring that universal service programs are appropriately funded and available and the Act includes low income usage reduction programs and the application of renewable resources within its definition of universal service and energy conservation measures. (See §2803, Title 66). Rising energy costs, the proposal to increase rates in this proceeding and a dependence on foreign oil compels the Commission to develop a meaningful and substantial investment in renewable and sustainable energy. This Company spent just \$2,415.00 on solar hot water heating applications in the year 2003. (Dahl Direct, PPL Statement No. 7, p. 10).

CEO has also requested that the Company continue to use local community based organizations in implementing its WRAP program. The Company has agreed to continue to use those local community based organizations. (N.H.T. pp. 734-

735). The ALJ failed to order that the Company continue to use local community based organizations in implementing its WRAP program as agreed to by the Company.

CONCLUSION

Based upon the above-cited exceptions, law and argument, it is respectfully requested that the PUC reject the ALJ's Recommended Decision as it relates to the issues above. Specifically, CEO is requesting the following:

1. That On-Track funding be increased immediately to a level that would serve 30,000 customers as recommended by the PUC in its June, 2003 Order;
2. That On-Track funding be increased so as not to decrease average benefit levels;
3. That the practice of restricting new participation in the On-Track program to customers with an overdue balance of at least \$150.00 be discontinued.
4. That the Company be ordered to equitably distribute HELP funds across the Commonwealth according to the percentage of low income customers in each county.
5. That the Company be ordered to increase WRAP funding in 2005 to the \$7 million annual level.
6. That the Company devote \$1 million annually from WRAP to expand the installation of solar hot water equipment in low income homes.

7. That the Company be ordered to continue the use of local community based organizations in implementing the WRAP program.

Respectfully submitted,

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PP&L ELECTRIC UTILITIES

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R-00049255

Request for a Rate Increase

CERTIFICATE OF SERVICE

I hereby certify that on the 11 day of November, 2004, I served a true and correct copy of Exceptions of Commission on Economic Opportunity re: Universal Service Programs via first class mail, postage prepaid, upon the following:

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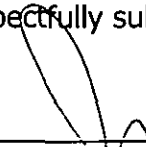
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November 12, 2004

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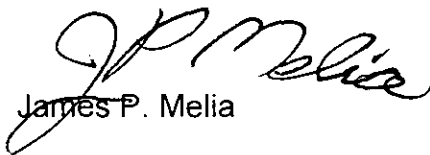
Re: Pennsylvania Public Utility Commission v. PPL Electric Utilities Corp.
Docket No. R-00049255

Dear Secretary McNulty:

Enclosed for filing please find an original and nine copies of the Exceptions of the Commercial Customer Consortium in this matter.

Copies of this document are being served on all parties of record.

Very truly yours,


James P. Melia

JPM/cem
Enclosures

cc: Hon. Allison K. Turner, ALJ (w/Enclosures)
Service List (w/Enclosures)

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HA-151366 v1 0606455-0801

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION
ADMINISTRATIVE LAW JUDGE ALLISON K. TURNER PRESIDING

Pennsylvania Public Utility Commission

v.

PPL Electric Utilities Corporation

Docket No. R-00049255

EXCEPTIONS OF COMMERCIAL CUSTOMER
CONSORTIUM

DOCUMENT

DOCKETED
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Dated: November 12, 2004

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SUMMARY OF EXCEPTIONS

The Commercial Customer Consortium ("CCC") excepts to ALJ Turner's Recommended Decision on two specific issues. First, the CCC excepts to the ALJ's adoption of the transmission surcharge ("TSC") as well as the ALJ's recommended recovery of the TSC in rates. CCC takes issue with the ALJ's adoption of PPL Electric Utilities ("PPL") proposed utilization of an energy-only surcharge mechanism for recovery of the TSC. CCC recommends, in the alternative, that any TSC charge reflect cost causation and the reality that these costs are generally demand-related as opposed to energy-related. CCC recommends that TSC-related charges be assigned to rate classes using transmission level demand allocators as recommended by Mr. Selecky.

CCC also excepts to the ALJ's rejection of Strategic Energy Ltd.'s ("SEL's") various recommendations which, if adopted, would result in an acceleration of retail competition in PPL's service territory. CCC believes that ALJ Turner rejected these recommendations in haste and that the Commission should give further consideration to requiring PPL to do the following: (i) accelerate the meter replacement program with introduction of newer retrofitted meters utilizing the AMR system; (ii) making available real-time customer usage information to support development of additional functionality; and (iii) provide EGSs with consolidated billing. The Commission should also consider and adopt other recommendations made by SEL in this proceeding.

EXCEPTIONS

I. EXCEPTION NO. 1 – CCC EXCEPTS TO THE ALJ’S ADOPTION OF THE TSC AS WELL AS THE ALJ’S RECOMMENDED RECOVERY OF THE TSC IN RATES.

CCC excepts to ALJ Turner’s recommendation for the adoption of the TSC as well as the ALJ’s recommended method for recovery of TSC charges through rates. (R.D. at pp. 124-139). In the R.D., ALJ Turner recommends adoption of the TSC as a mechanism for recovery of transmission-related charges incurred by PPL due to a projected increase in charges for transmission services representing purchases from the PJM interchange in the amount of \$57 million. (R.D. at p. 124). Initially, CCC rejects adoption of the TSC through an automatic adjustment clause because: (i) transmission charges are not as volatile as fuel costs and need not be updated on a more frequent basis than a rate filing; (ii) automatic pass-through of this significant charge eliminates incentives to control these costs; (iii) increases in sales will provide revenues that will offset some or all of the transmission-related costs. (CCC Main Brief, p. 11). CCC was not alone in objecting to recovery of transmission-related charges through a TSC. OTS also objects to recovery of these charges. (OTS St. No. 5, pp. 7-15). For the foregoing reasons, CCC reiterates its request that the TSC be rejected in *its entirety*.

CCC also recommended that, if a TSC is adopted, the ALJ and Commission should reject PPL’s Alternatives 1 and 2 for recovery of the TSC because both alternatives recover the TSC on a uniform cents per kWh (e.g., energy) basis for all customer classes. (R.D. at pp. 137-138). PPL’s Alternative No. 1 Proposal is for the TSC to be recovered on a uniform rate per kWh basis for all classes. PPL’s Alternative

No. 2 Proposal would involve allocating TSCs among three broad categories of customers with a different uniform rate per kWh for each broad category. (R. D. at pp. 137-138).

CCC and many other parties rejected recovery of the TSC in this manner because it fails to reflect cost causation and ignores the reality that these costs are generally demand-related as opposed to energy-related. CCC recommended that TSC-related charges should be assigned to rate classes using transmission level demand allocators. After the costs are assigned, kW or kWh charges for each class can be developed from the billing determinants. (CCC St. No. 1, p. 13; CCC Main Brief, p. 13).

CCC illustrated the detrimental impact of the adoption of the ALJ's recommendation through its comparison of the distribution demand allocator and energy allocator shown on CCC Exhibit No. 3 (JTS-3). As this exhibit demonstrates, if transmission costs are collected as a uniform energy charge, rate classes GS-3 and LP-4 will be allocated an unfairly large portion of transmission costs. (CCC St. No. 1, pp. 12-13; CCC Main Brief, p. 13).

It should also be noted that transmission costs are demand-related just as are distribution costs. The ALJ recommends, at p. 144 of the R.D., that the Commission rely primarily on PPL's cost of service study ("COSS") for guidance. (R.D. at p. 144). PPL's own COSS allocates distribution costs on the basis of demand. If distribution costs are so allocated, there is no logical reason why transmission costs should not be allocated on the basis of demand if further cross-subsidies are to be avoided.

Adoption of a TSC charge on a per kWh basis (or energy basis), because of its simplicity, does not justify the unfairness of the results that it produces, which is to further exacerbate the existing cross-subsidy issue that the Commission already recognizes. The Commission should adopt a method that will not further aggravate this already untenable situation.

Other parties provided similar arguments supporting the adoption of a demand-related TSC charge. For example, PPLICA supports the TSC but only so long as it is not charged on a cents per kWh basis. PPLICA's proposal is that the TSC would be allocated to each rate class based upon the PJM OATT method and be recovered from the various rate classes with interval-metering based upon demand and energy cost elements. (R.D. at p. 138; PPLICA St. No. 1 and Exhibits).

OSBA proposes to allocate each year's TSC among rate classes based upon a five-year average of each rate class' coincident peak and kWh usage. (R.D. at p. 137; OSBA St. No. 1 and Exhibits).

The essence of PPLICA's criticism of PPL's preferred proposal is that a uniform cents per kilowatt-hour recovery will create a distortion in the comparison-to-shop transmission price for customers. To adopt a TSC allocation mechanism on a uniform cents per kWh basis will only exacerbate existing cross subsidies between rate classes and do little to bring about true cost of service rates within the PPL service territory.

For the foregoing reasons, CCC recommends rejection of ALJ Turner's recommended recovery of the TSC on an energy-only basis and recommends that recovery of the TSC occur on a demand basis.

II. EXCEPTION NO. 2 – CCC EXCEPTS TO THE ALJ'S REJECTION OF SEL'S RECOMMENDATIONS.

ALJ Turner rejected all of SEL's recommendations advocating the acceleration of retail competition in PPL's service territory. (R.D. at pp. 176-178). ALJ Turner rejected SEL's recommendations in the following areas which were also supported by CCC: (i) acceleration of the meter replacement program with introduction of newer retrofitted meters utilizing the AMR system; (ii) making available real-time customer usage information and the ability of the AMR platform to support development of additional functionality; (iii) provide EGSs with updated eligible customer lists and distribute related "opt-out" cards to customers; (iv) accept an EGS's telephonic representation that a customer has authorized the release of customer information; and (v) provide EGSs with consolidated billing. (SEL St. No. 1, pp. 6-7).

CCC contends the ALJ exercised undue haste in rejecting all of these proposed recommendations for improving retail competition in the PPL service territory. PPL alleges that many of these programs are underway and that acceleration is not necessary. (R.D. pp. 178-179). On the contrary, CCC believes that there has been delay in implementing these improvements as alleged by SEL. Many of CCC's constituents are served by SEL and have experienced first-hand the results of delayed implementation of these measures. Acceleration of AMR system implementation and consolidated billing would bear immediate benefits to CCC members. For the foregoing reasons, CCC recommends that ALJ Turner's Order be reversed and that PPL be required to implement some or all of the proposed measures recommended by SEL in this proceeding.

CONCLUSION

WHEREFORE, for all the foregoing reasons, the Commercial Customer Consortium respectfully requests that its Exceptions to ALJ Turner's Recommended Decision be adopted.

Respectfully submitted,


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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility
Commission

v.

PPL Electric Utilities, Inc.

Docket No. R-00049255

CERTIFICATE OF SERVICE

I hereby certify that I have this day served true and correct copies of the foregoing document upon the individuals listed, in accordance with the requirements of Section 1.54 (relating to service by a participant).

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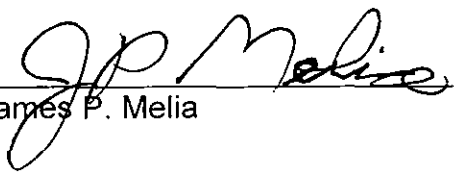
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Re: Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation;
Docket No. R-00049255; **PPL PUBLIC LIGHTING USER GROUP'S
EXCEPTIONS**

Dear Mr. McNulty:

Enclosed for filing please find an original and nine (9) copies of PPL Public Lighting User Group's Exceptions in the above-referenced proceeding.

A copy of the Exceptions have been provided to the Commission's Office of Special Assistants on a 3 1/2 computer disk in Microsoft Word 6.0 format.

Please date-stamp the extra copy and return with our messenger service. Please feel free to call the undersigned with any questions regarding this filing. Thank you in advance for your cooperation.

Sincerely,

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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Pennsylvania Public Utility Commission
et al.,

Complainants

v.

PPL Electric Utilities Corporation,
Respondent

Docket No. R-00049255 *et al.*

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EXCEPTIONS
OF PPL PUBLIC LIGHTING USERS GROUP (PPL PLUG)
TO THE RECOMMENDED DECISION OF
ADMINISTRATIVE LAW JUDGE
ALLISON K. TURNER ISSUED ON OCTOBER 22, 2004

DOCKETED
NOV 23 2004

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The PPL Public Lighting Users Group (“PPL PLUG”) hereby excepts to portions of the Recommended Decision of Administrative Law Judge Allison K. Turner (“ALJ Turner”) issued on October 22, 2004, as set forth below:

I. ALJ Turner Failed to Identify PPL PLUG as an Active Participant that Filed a Brief and Reply Brief (R.D. at 5)

In her Recommended Decision, ALJ Turner identified the active parties that filed briefs and reply briefs. R.D. at 5. She omitted PPL PLUG from the list of parties that filed Main Briefs and Reply Briefs. PPL PLUG filed its Main Brief on the due date, September 2, 2004, and filed a Reply Brief on the due date, September 13, 2004.

II. Regarding Traffic Lighting Service, ALJ Turner Appropriately Recommended that PPLEU Should Cooperate in Advancing Deployment of LED Traffic Lights, but Gave Insufficient Guidance to the Structure This Cooperative Effort Should Take (R.D. at 157-58)

In her discussion on traffic lighting service, the Recommended Decision apparently omits (presumably inadvertently) PPL PLUG’s position with respect to traffic lighting, since the Recommended Decision contains a heading “traffic lighting” but begins that section with the Company’s response. The section in the Recommended Decision that addresses traffic lighting concludes that “the ALJ favors PLUG’s intention to expand the use of LED traffic signals in this area as energy saving and efficient, and recommends that the Commission encourage PPLEU to cooperate with this effort.” R.D. at 158.

PPL PLUG’s position on traffic lighting was twofold: (1) that PPLEU should be directed to institute an unmeasured rate for traffic signal systems, particularly for intersections with LED lamps; and, (2) should offer a demand-side response program for LED lights. PPL PLUG M.B. at 16-18. ALJ Turner concludes that an effort should be made to expand the use of LED traffic

signals – a conclusion with which PPL PLUG concurs – but is spartan with respect to concrete suggestions.

PPL PLUG submits that both of its suggestions would be useful in invigorating the deployment of LED lights.¹ Joseph Link, City Engineer for Harrisburg, testified in support of a traffic signal rate similar to the separate tariff classifications for street lighting. He analogized traffic lighting to street lighting by noting its similarity to the criteria given by PPL for its tariffing street lighting as a flat rate: (1) it has a large amount of directly assignable end-use equipment; (2) it provides unique service conditions; and, (3) has no services investment to the assigned class. PPL PLUG Exhibit No. 4. Other Pennsylvania electric utilities (PECO Energy, Duquesne Light Company, and Metropolitan Edison, all of which serve major metropolitan areas) have separate unmeasured rate schedules for traffic lighting service. Increased usage of LED lights in traffic signals particularly makes a non-measured rate schedule compelling since such lights have very long lives and their electricity fluctuates microscopically. PPL PLUG submits that the Commission should direct PPLEU to institute a new non-metered tariff for traffic signal systems equipped with LED lights by its next distribution rate case, because the usage is ascertainable and varies very little. The tariff would impose on municipalities a duty to advise the utility of the usage characteristics of the traffic signal equipment at each intersection and the timing of use. PPL PLUG provided an example of a tariff. See PPL PLUG Exh. No. 3.

More importantly, a deployment of LED lights would be manifestly enhanced if this Commission were to direct PPL to develop a rebate program similar to other states. Thomas J. Tuffey, Executive Director of the Sustainable Energy Fund, noted that LED technology has been only slowly adopted in central Pennsylvania. SEF St. No. 1 at 25. According to Mr. Link,

¹ LED lights use less than 15% of the electricity used by incandescent bulbs (PPL PLUG St. No. 2 at 3) and are more visible, thus enhancing public safety (PPL PLUG St. No. 1 at 5).

deployment has been retarded because many communities cannot budget the upfront costs, “even though they will reduce their costs forever.” PPL PLUG St. No. 2 at 4. This Commission has the power to direct PPLEU to institute a conservation program such as an LED rebate program, pursuant to Section 1505(b) of the Public Utility Code² so long as it is “prudent” and “cost effective.” There can be no argument that installing technology to reduce usage by 85% or more in a particular targeted area is *prudent* and *cost effective*. PPL PLUG, however, acknowledges that the concept should be studied further before implementation in a system-wide basis, so that the scope of the program and magnitude of the rebates can be determined. Therefore, in order to further ALJ Turner’s directive that PPL cooperate with efforts to encourage LED traffic light proliferation, PPL PLUG proposes the establishment of a working group, including the City of Harrisburg and the SEF (as an invited member), with Commission oversight. The working group would have as its first priority developing a rebate program for LED traffic signals. The second agenda item for the working group would be development of a non-measured LED traffic signal system tariff for a pilot program. PPL PLUG asks that the working group complete its evaluation within 12 months of the Commission’s final order in this proceeding and the rebate program should be in place within 18 months.

III. With Respect to Street Lighting Rates, ALJ Turner Gave Insufficient Weight to Compelling Testimony that Street Lighting Rates Should Either Not Be Increased or Should Be Increased More Gradually Because the Service Is a Public Good and Because It Is *De Facto* Interruptible (R.D. at 158-60)

ALJ Turner concluded that PPL PLUG would be receiving an appropriate rate increase under the PPLEU recommendation. R.D. at 160. In part, that is because street lighting rates pay

² 66 Pa. C.S. §1505(b).

below system average rate of return. She agreed with PPL PLUG that street lighting service is a “public good” but did not give recognition to that fact in establishing street lighting rates. Unfortunately, she also did not freeze street lighting rates on the basis of the quality of service; she agreed with the Company that PPL PLUG did not demonstrate that its quality of service warranted a designation of “interruptible” service. PPL PLUG strongly disagrees with ALJ Turner on both issues and asserts that its rates should not be increased.

ALJ Turner concurs with PPL PLUG that street lighting is a public good because street lighting customers do not consume electricity for their own benefit – they consume it to provide lighting for citizens on the streets and public areas and to assist the police, firefighters, and other emergency responders in the performance of their duties to protect the public. PPL PLUG contends that street lighting rates may be limited because street lighting is a public good, similar to fire hydrant service or volunteer fire company service. ALJ Turner fails to mention that street lighting is also highly supportive of security concerns. Mr. Bradley, Manager of Hampden Township, Cumberland County, stated that “never has security been more important than it is today.” PPL PLUG St. No. 1-R at 3. At this point, PPL PLUG and ALJ Turner diverge. She does not find a basis for reducing any increase to street lighting customers on that basis. PPL PLUG contends that such a reduction is warranted and desirable, especially when considered in conjunction with the interruptible nature of the service.

PPL PLUG established the following facts with respect to the quality of street lighting service (except for energy-only customers³):

- PPL is responsible for maintaining street lights under Rates SA, SHS, SM, and SR-1.

³ Energy-only street lighting customers (customers taking service under Rate SE) own their street lights. Therefore, PPLEU does not have the responsibility for maintaining those lights. The discussion set forth in these exceptions does not relate to energy-only, or Rate SE, customers.

- PPL provides no service or manpower to identify when its own equipment (street lights) are not working.
- Municipal customers are forced to send out their staff (often the police) to monitor the condition of PPL facilities. Street light customers must patrol PPL's facilities 365 days a year, as a condition of service, to assure that they have continuous service.
- PPL street lighting service has deteriorated, such that PPL cannot be relied upon to replace burnt-out lights in a timely manner. PPL's own witness, Mr. Kasper, testified that the number of bulb outages were "increasing dramatically" after PPL decided to repair lights on an as needed basis, as did customer complaints. (N.T. 1000, 1005).
- PPL changes its repair forms frequently, as well as its points of contact, thereby frustrating expeditious repairs.
- PPL refuses to give customers feedback as to requests for repairs.
- PPL has no agreement with the municipalities it serves to patrol street lights.
- Street light customers receive absolutely no monetary credit for the time their lights are non-functional.⁴

In other words, street lighting customers are expected to pay for firm service, even though they are subject to routine and regular interruptions. Furthermore, they have to dedicate significant resources to assure a reasonable quality of service.

See PPL PLUG M.B. at 6-13.

PPL PLUG contends that the service rendered to street lighting customers, with the exception of customers taking service under Rate SE, are essentially being provided with interruptible utility service. They further contend that their rates should reflect the uncertainties

⁴ Unlike telephone customers, which do receive credit for every 24-hour period they are out of service, 52 Pa. Code § 63.24 (service interruptions).

of interruptible service. As the Commission noted in Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, Docket No. R-00943081 (1995 Pa. PUC Lexis 8):

To the extent that customers who may be interrupted, for whatever reason, take lower reliability service, the cost of providing the service is lower than the equivalent amount of firm service. This difference between firm rates and interruptible rates is typically in the form of an “interruptible credit” or “interruptible discount.”

In this case, PPLEU acknowledges that street light customers currently receive absolutely no monetary recognition that PPLEU owns street lights that may go out at any time and stay out for an indeterminate period. PPL PLUG Exh. No. 1. Furthermore, PPLEU’s cost of service study does not at any point give recognition to the interruptible nature of street lighting service.

The Public Utility Code contains a general mandate that rates should be just and reasonable.⁵ PPL PLUG acknowledges that the Code does not explicitly mandate that street lighting service should pay less than system average rate of return. However, PPL argues that given the nature of street lighting customers usage of electricity, the Commission may and should, within its discretion, determine that street lighting rates must not recover any more than the full cost of service.⁶ They already pay that and more. Rather, street lighting rates may remain as they currently exist – that is, paying full cost of service, plus making a contribution to system-average rate of return.

⁵ Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301.

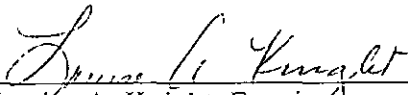
⁶ For example, public fire protection service, also a “public good,” is allowed to pay only 25% of the cost of its service and makes no contribution to the company’s return. See also Nat’l Utils., Inc. v. Pa. Pub. Util. Comm’n., 709 A.2d 972 (Pa. Cmwlth. 1998) (holding that when a public utility fails to provide adequate service, it may be denied a rate increase even if the result is a rate of return less than it would otherwise receive).

IV. Conclusion

WHEREFORE, PPL PLUG asserts that its street lighting rates are already at an appropriate level, considering that its service has a lower reliability, that street lighting customers must expend substantial resources in assuring that PPL is rendering adequate and continuous service and that street lighting service is a public good. Its rates simply should not be increased at this time and PPL should be directed to take into account the interruptibility of this service and the public good provided in its next distribution rate case.

With respect to traffic lighting, the Commission should take tangible concrete steps via instituting a pilot program – to develop an unmeasured traffic signal system tariff and to develop a rebate program for LED traffic signals.

Respectfully submitted,


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CERTIFICATE OF SERVICE

I hereby certify that I am this day serving a copy of PPL PUBLIC LIGHTING USERS GROUP EXCEPTIONS TO THE RECOMMENDED DECISION OF ADMINISTRATIVE LAW JUDGE ALLISON K. TURNER ISSUED ON OCTOBER 22, 2004 upon the participants listed below in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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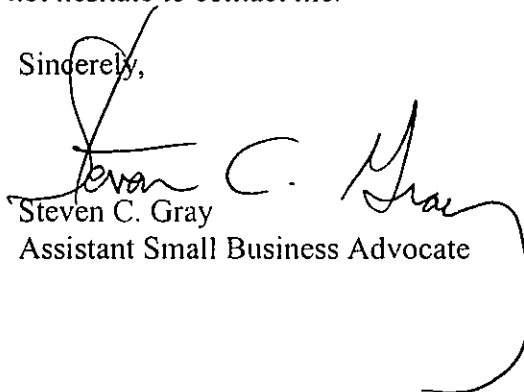
**Re: Pennsylvania Public Utility Commission v.
PPL Electric Utilities Corporation
Docket No. R-00049255**

Dear Secretary McNulty:

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

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

Sincerely,


Steven C. Gray
Assistant Small Business Advocate

Enclosures

cc: Cheryl Walker Davis, Director
Office of Special Assistants
(w/disk)

Parties of Record

Robert D. Knecht

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

v.

**PPL ELECTRIC UTILITIES
CORPORATION**

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Docket No. R-00049255

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

DOCUMENT

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NOV 23 2004

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Dated: November 12, 2004

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I. INTRODUCTION

On March 29, 2004, the PPL Electric Utilities Corporation (“PPL” or the “Company”) filed with the Pennsylvania Public Utility Commission (“Commission”) a request for additional annual distribution revenues of \$164.4 million. The PPL filing also included a notice that transmission service charges were expected to increase by \$57.2 million, a proposal for recovering transmission charges from ratepayers on a reconcilable basis, a request for the implementation of a distribution system improvement charge (“DSIC”), and a request for ratepayer funding for the Sustainable Energy Fund of Central Eastern Pennsylvania (“SEF”).

On April 8, 2004, the Office of Small Business Advocate (“OSBA”) filed a complaint against the PPL filing. On May 7, 2004, the Commission suspended the proposed effective date of PPL’s filing and instituted an investigation into the justness and reasonableness of PPL’s proposals.

On May 19, 2004, a prehearing conference was held before Administrative Law Judge (“ALJ”) Allison K. Turner, ALJ Susan D. Colwell, and Chief ALJ Robert A. Christianson.

Public input hearings were held throughout the PPL service territory during the week of June 28, 2004.

On June 29, 2004, the OSBA submitted the direct testimony of Robert D. Knecht and Mark D. Ewen and, in a separate document, the direct testimony of Andrew M. Schwarz. On July 27, 2004, the OSBA submitted the rebuttal testimony of Messrs. Knecht and Ewen. On August 5, 2004, the OSBA submitted the surrebuttal testimony of Messrs. Knecht and Ewen.

Evidentiary hearings were held in Harrisburg beginning August 9, 2004, and concluding August 12, 2004. An additional telephonic public input hearing was conducted on August 13, 2004.

On September 2, 2004, the OSBA submitted a main brief.

On September 13, 2004, the OSBA submitted a reply brief.

On October 22, 2004, ALJ Turner issued a recommended decision ("RD").

On October 25, 2004, the Commission issued an errata sheet to the RD.

The OSBA submits these exceptions in response to the RD.

II. EXCEPTIONS

1. **The ALJ RD incorrectly concluded that a properly designed and approved DSIC should be granted by the Commission after legislative guidance is obtained. (RD at 47)**

The ALJ correctly concluded that the DSIC mechanism proposed by PPL in its original filing should be denied.¹ The ALJ gave the following reasons why she recommended the disallowance of the Company's proposed DSIC mechanism:

- The Commission's prior approval of the water utilities' DSIC and the wastewater utilities' Collection System Improvement Charge ("CSIC") mechanisms was predicated on the existence of water and wastewater systems that were deteriorating. PPL has offered no evidence that its facilities are deteriorating and in need of serious repair.²
- The Company's electrical system is not analogous to water and wastewater systems.³
- Unlike the acquisition of water and wastewater companies in need of improvement, PPL has not acquired any new service territory or companies in need of such improvement.⁴

¹ RD, at 47.

² RD, at 46.

³ RD, at 46.

⁴ RD, at 46.

- There is no evidence that PPL’s rate of return was inadequate prior to PPL’s being placed under a rate cap, and no evidence that the Company’s level of service has suffered without a DSIC’s being in place.⁵
- The legislature’s enactment of a series of amendments to 66 Pa. C.S. § 1307 “makes clear that [the legislature] has not entirely delegated the power and authority to fashion such rate mechanisms [PPL’s DSIC] to the Commission.”⁶
- The minimal time (one month) that the Company’s DSIC proposal would allow for the review of the year’s charges would render that review inadequate and meaningless.⁷
- The substantive (“context”) review that would be provided in the limited DSIC proceeding would be inadequate.⁸
- There was no sunset date proposed for the DSIC. “The need for repairing and replacing aging plant . . . should come to an end.”⁹
- The proposed DSIC would make the price-to-compare difficult to calculate, thereby harming the nascent competitive marketplace.¹⁰

However, despite this long list of reasons for rejecting PPL’s proposal, the ALJ also recommended “that a properly designed and approved DSIC be approved by the

⁵ RD, at 46.

⁶ RD, at 43.

⁷ RD, at 45.

⁸ RD, at 44.

⁹ RD, at 46.

¹⁰ RD, at 46.

Commission after legislative input.”¹¹ The OSBA respectfully disagrees with this recommendation.

First, the ALJ apparently based this recommendation upon her belief that “[i]n a new competitive market place, procedures should be streamlined, but still meaningful.”¹² However, the ALJ’s belief is not a basis upon which the Commission can disregard the express language of the Electricity Generation Customer Choice and Competition Act (“Act”). The Act requires that the “transmission and distribution of electricity . . . continue to be regulated as a natural monopoly subject to the jurisdiction and *active supervision* of the commission.”¹³ Thus, it is contrary to the language of the Act to allow the regulation of an electric distribution company’s (“EDC”) distribution system to be streamlined, minimized, altered, or in any way impaired. Furthermore, the General Assembly wanted to foster a competitive marketplace for electric generation, not lessen the requirement that the Commission oversee the operation of EDC distribution and transmission systems. As the legislature made clear, “[r]eliable electric service is of the *utmost importance* to the health, safety and welfare of the citizens of the Commonwealth.”¹⁴

Second, there is no “legislative input” to consider in this proceeding. The legislature has not passed any further amendments to 66 Pa. C.S. § 1307 that would have bearing on a DSIC mechanism similar to what PPL proposed in this case.

¹¹ RD, at 47.

¹² RD, at 47.

¹³ 66 Pa. C.S. § 2802(16) (emphasis added). This citation appears under the heading “Declaration of Policy.”

¹⁴ 66 Pa. C.S. § 2802(12) (emphasis added).

Third, while the ALJ may believe that “a properly designed and approved DSIC” mechanism should be approved by the Commission, no such mechanism is a part of this record. If such a hypothetical DSIC mechanism were proposed at this late date, due process would require full evidentiary hearings on the mechanism. Furthermore, the parties would undoubtedly contest not only what constitutes a “properly designed” DSIC mechanism, but whether the phrase “properly designed DSIC mechanism” itself is not simply an oxymoron.

Therefore, the OSBA respectfully requests that the Commission reject the ALJ’s recommendation to approve a non-existent “properly designed and approved DSIC” mechanism “after legislative input.”

2. The ALJ incorrectly concluded that the proposed SEF surcharge revenue should not be transferred to PEDA. (RD at 87-88)

The ALJ recommended that the Commission adopt the PPL proposal to fund the SEF as part of the Company’s distribution rates at the level of 0.01 cents per kWh from all customers through December 31, 2009.¹⁵ However, beyond merely accepting the PPL SEF proposal as filed (and quoting a PPL suggestion for a possible separate proceeding on the operation of the SEF), the ALJ did nothing to correct the SEF’s problems identified by the OSBA.

The ALJ did summarize the OSBA position as to why any new SEF funding should be redirected to PEDA. However, the ALJ recommended no remedies for SEF’s

¹⁵ RD, at 77-78.

questionable selection of projects,¹⁶ its vague project selection process,¹⁷ the failure to spend the money it has already received,¹⁸ its loss of money in the stock market,¹⁹ its high administrative costs,²⁰ the selection of its directors,²¹ the potential conflicts of interest for those directors,²² and the lack of any meaningful oversight by the Commission.²³

In an apparent acknowledgement that she agrees that the aforementioned are problems with the SEF, the ALJ suggested that funding could be phased-out over the next five years.²⁴ However, she made no explicit recommendation to that effect.

Furthermore, the ALJ did not explicitly recommend the Company's proposal for a separate proceeding if the Commission "has concerns" regarding SEF's "program management and evaluation, project selection, or governance."²⁵ However, she did implicitly endorse the PPL proposal by citing it immediately before ending the RD's SEF section.²⁶

¹⁶ OSBA Main Brief, at 28-29.

¹⁷ Id., at 29-30.

¹⁸ Id., at 30-31.

¹⁹ Id., at 31.

²⁰ Id.

²¹ Id., at 31-32.

²² Id., at 32-33.

²³ Id., at 33-34.

²⁴ RD, at 87-88.

²⁵ RD, at 88.

²⁶ Id. It should be noted that on page 88 of the RD, the ALJ's citations for the source of this PPL suggestion are both incorrect. The Company's quoted language actually appears in the PPL Reply Brief on page 82.

The OSBA agrees with the ALJ's implicit finding that there are program management, project evaluation, project selection, and governance problems with the SEF. These are precisely some of the reasons why the OSBA has advocated that the surcharge funding be placed under the direction and control of the Pennsylvania Energy Development Authority ("PEDA"). Unfortunately for PPL's ratepayers, the ALJ addressed the OSBA's proposal simply by observing that "PEDA is an inactive state agency that Governor Rendell is trying to revive."²⁷ The ALJ's characterization of PEDA ignores the importance the Governor has assigned to PEDA and to renewable energy.²⁸

Furthermore, the ALJ gave no apparent weight to her own finding that "PPLICA has very effectively demolished the Bear Creek Wind Farm evidence, and exposed it as failing to show a viable project that will return benefits soon."²⁹ Instead, the ALJ observed that the "standard of proof" before the Commission is a preponderance of the evidence.³⁰ The ALJ took that standard; mixed in the observation that "[t]here is evidence of mistakes, and evidence of successes"; added in PPL's belief that SEF "is well run and has a strong balance sheet"³¹; and conjectured that under the Act "there should be a place and a role for organizations like SEF in the new market place."³²

²⁷ RD, at 81.

²⁸ See OSBA Statement No. 2, at 6; See also PPL Statement No. 7, at 24-25.

²⁹ RD, at 87.

³⁰ RD, at 87.

³¹ RD, at 87. This is evidence that has no probative value. PPL admitted that it knows little about the operation of SEF. See OSBA Statement No. 2, at 3.

³² RD, at 87.

In view of the foregoing, the OSBA respectfully suggests that the Commission disregard the RD on this issue, and (if the SEF surcharge is approved) require that the revenue be placed under the direction and control of PEDDA. In the alternative, the OSBA agrees with the Company's suggestion of a separate proceeding on the operation, management, and fiscal responsibility of the SEF.

Finally, if the Commission is unwilling to redirect the SEF funding to PEDDA, or to initiate a separate proceeding on SEF's problems, the OSBA respectfully requests that the Commission make clear that parties are free to challenge the SEF in the next distribution rate case, even if that case occurs before the December 31, 2009, SEF "sunset" proposed by PPL. By making clear that the surcharge is not being approved through December 31, 2009, the Commission would give the SEF an incentive to improve, and would insure that a forum would be available in which SEF's improvements (or SEF's failure to improve) could be evaluated.

3. **The ALJ incorrectly concluded that if the Commission does not select the Company's originally filed reconcilable Transmission Service Charge, the Commission should choose PPL's Alternative 2 as the methodology for allocating the PJM transmission charges. (RD at 139-140)**

The ALJ recommended that the Commission adopt PPL's original proposal that would create an energy-based, reconcilable transmission service charge ("TSC") mechanism to recover the costs associated with the PJM transmission charges for the Company's provider of last resort ("POLR") customers. The ALJ further recommended that if the Commission decides against the Company's original energy-based TSC

proposal, PPL's Alternative 2 proposal for allocating the PJM charges should be adopted.³³

The ALJ apparently found merit in the Company's Alternative 2 proposal because the allocation of the PJM charge would be performed in a manner similar to the intangible transition charge ("ITC") and competitive transition charge ("CTC") reconciliations.³⁴ However, the fact that PPL Alternative 2 may exhibit certain characteristics similar to how the Company performs its ITC and CTC reconciliations is not sufficient to overcome the volatility problem inherent in the PPL Alternative 2 methodology.

³³ RD, at 139-140.

³⁴ RD, at 139-140.

Specifically, as explained by OSBA witnesses Robert D. Knecht and Mark D.

Ewen:

As we also discussed in rebuttal, we share Mr. Krall's concerns about the rate volatility that will result if Mr. Baron's approach is adopted exactly as he proposed. However, Mr. Krall's proposal to aggregate rate classes will not solve the rate volatility problem. As shown in his Exhibits DAK-3 and DAK-4, the aggregate 'commercial' transmission charge is 31 percent higher in a summer peak than in a winter peak (\$6.49 per MWh with a summer peak versus \$4.95 per MWh with a winter peak). This range implies that PPL's proposal will result in rates that are unacceptably volatile. Our proposal for a five-year rolling average as presented in our rebuttal testimony, even on an individual rate class basis, will provide much greater transmission rate stability.

OSBA Statement No. 4, at 9.³⁵

The Commission faces a difficult decision if it rejects the ALJ's recommendation to adopt the Company's original reconcilable TSC proposal. Each of the alternative proposals includes a demand component which will, as a result of PPL's random summer and winter peaking nature, introduce a degree of volatility into the allocation of the PJM transmission charges. The OSBA proposal is the best of the alternatives because it both mirrors the design of the PJM transmission charges, and reduces the volatility of those charges.³⁶

³⁵ Note that the ALJ reversed the relative size of the two components of the PJM charge:

They argue for a rate basically mirroring the way PJM breaks down its charges to PPLEU and other load-bearing entities (EDCs and EGSs) under the OATT, which is about 70% based on consumption, and 30% based on demand.

RD, at 134. In fact, contrary to the ALJ's summary, the PJM charges are about 70% based on demand and 30% based on consumption.

³⁶ See OSBA Main Brief, at 16-21, for a full discussion of the issues involved in creating an allocation of the PJM transmission charges.

The ALJ expressed support for the OSBA proposal, although ultimately she did not adopt it. For example, in comparison to the PPLICA proposal (which essentially passes through the transmission charges using PJM's tariffed rate design), the ALJ hailed the OSBA alternative as "a kinder, gentler modification of PPLICA's proposal."³⁷ Furthermore, the ALJ included the "rate stability" and "cost causation" lists from the Company's main brief in the RD.³⁸ PPL's "rate stability" list placed the OSBA proposal in second place (i.e., the OSBA proposal produced rates that are nearly as stable as the Company's original TSC proposal). In contrast, the Company's "cost causation" list placed the OSBA proposal in fourth place, a ranking which the OSBA strongly disputed. The ALJ apparently agreed with the OSBA objection to this "cost causation" ranking, because she quoted the OSBA's reply brief on this issue and observed in a footnote that other parties had commented favorably upon the OSBA proposal.³⁹ The ALJ concluded by pointing the reader to the "admirably set forth" testimony and exhibits of the OSBA that addressed this issue.⁴⁰

Therefore, the OSBA respectfully requests that the Commission select the OSBA transmission charge proposal if it declines to approve the original PPL TSC proposal.

³⁷ RD, at 134. The OSBA proposal uses the underlying PJM rate design (which employs both peak demand and energy components), but overlays a five-year rolling average on the peak demand component in order to reduce the impact that the volatile PJM rates would have on PPL's smaller customers. See OSBA Statement No. 3, at 8-9.

³⁸ RD, at 137-138.

³⁹ See RD, at 138-139.

⁴⁰ RD, at 139.

4. The ALJ incorrectly and tacitly approved the “10% Total-Bill” benchmark for gradualism. (RD at 151)

In its original filing, PPL set forth a series of limitations which would restrict the size of the rate increase allocated to any specific customer class. Specifically, the Company proposed to limit the rate increase for each customer class to 10%, measured on a “total-bill” basis.⁴¹ The Company set this “10% total-bill” benchmark as a goal in order to minimize “rate shock” to any particular customer class.⁴²

Throughout the RD, the ALJ cited PPL’s goal to limit any increase to any particular customer class to a “10% total-bill” basis.⁴³ However, the ALJ’s decision lacks any analysis of the justness and reasonableness of this version of gradualism proposed by the Company. The ALJ also failed to address the fact that the “10% total-bill” benchmark is not supported by one shred of evidence that demonstrates its justness and reasonableness.⁴⁴ Furthermore, the ALJ did not address any of the concerns raised by the OSBA regarding the “10% total-bill” benchmark.⁴⁵

The OSBA’s interpretation of the principle of gradualism, applied to the facts of this proceeding, is that the “total-bill” rate increase for any single customer class should be limited to twice the system average rate increase (measured on a percentage basis). For example, if the system average rate increase is determined to be 7 percent, the OSBA

⁴¹ See PPL Statement No. 4, at 27. The “total-bill” basis refers to the sum of a customer class’ transmission, distribution, and generation charges.

⁴² See PPL Main Brief, at 14-15.

⁴³ See, e.g., RD, at 128, 133, 139, 141, 145.

⁴⁴ See OSBA Main Brief, at 6-8. The extent of the ALJ’s analysis on this issue appears to be her tautology that “PPLEU’s version of gradualism is actually gradual for the bulk of its ratepayers” See RD, at 151.

⁴⁵ See OSBA Statement No. 1, 26-27.

proposal would restrict the rate increase for any individual customer class to 14 percent on a total-bill basis.⁴⁶ This interpretation of the principle of gradualism is no less valid than the “10% total-bill” rule proposed by the Company. In fact, the OSBA proposal grants the Commission a greater degree of latitude in which to move the customer classes closer to their cost of service, while still limiting the rate increases for those classes to a moderate level.

Therefore, the OSBA respectfully requests that the Commission reject the ALJ’s tacit acceptance of PPL’s proposed “10% total-bill” benchmark as a proper measure of gradualism for customer class rate increases, and instead adopt the OSBA proposal to limit customer class rate increases to twice the system average rate increase on a total-bill basis.

5. The ALJ incorrectly recommended the adoption of the Company’s original distribution service revenue allocation. (RD at 151)

In the concluding paragraph of the RD section entitled “Rate Structure – Distribution,” the ALJ stated:

The ALJ would like to see some relief given to small business consumers of PPLEU’s distribution service.

RD, at 151. The OSBA welcomes the ALJ’s sentiment, and respectfully submits that the ALJ’s professed desires can be satisfied in this proceeding.

⁴⁶ See OSBA Main Brief, at 13-14. Other parties advocated different interpretations of the principle of gradualism. For example, PPLICA advocated that gradualism would allow all customer classes to be moved to their respective cost of service in stages over three years. See PPLICA Main Brief, at 95-96.

The ALJ cited statutory and case law to provide the legal foundation upon which to base her recommendation for a revenue allocation in this proceeding. The ALJ quoted the Commission, as follows:

Public utility rates should enable the utility to recover its cost of providing service and should allocate this cost among the utility's customers in a just, reasonable and **nondiscriminatory** manner.

Pa. PUC v. The Peoples Natural Gas Company, Docket No. R-832315 (Order Entered January 13, 1984), at 84 (emphasis added).⁴⁷

Unfortunately for PPL's small commercial and industrial customers, the ALJ ignored the serious problems with PPL's proposal (as well as the mandate of the Commission in *Peoples*) and recommended that the Commission adopt the Company's original revenue allocation.⁴⁸ Although the RD summarized the revenue allocation proposals of the various parties in this proceeding, the ALJ refrained from providing any analysis as to why she recommended the Company's revenue allocation. Instead, the ALJ simply concluded:

The Company and the OCA argue that the Company's proposed revenue allocation produces a reasonable result. OCA supports its adoption in this proceeding. The ALJ agrees.

RD, at 151.

It is understandable that the OCA would choose to support the adoption of the Company's revenue allocation proposal. As it was originally filed, the Company's

⁴⁷ The ALJ also cited to 66 Pa. C.S. §§ 1301 and 1304, which, respectively, require rates to be just and reasonable, and to be nondiscriminatory. In addition, the ALJ cited to *Peoples Natural Gas Company v. Pa. P.U.C.*, 409 A2d 446, at 455 (Pa. Cmwlth. 1979), for the proposition that rates do not have to be identical for each class, provided that there is a **reasonable basis** for the difference. See RD, at 140 (emphasis added).

⁴⁸ RD, at 151. The Company's revenue allocation scheme is the result of the broad and inflexible doctrine set forth in PPL's direct testimony. See PPL Statement No. 6, at 8-10.

distribution revenue allocation proposal produced a system average increase of 32.8% in distribution rates. However, PPL's proposed allocation assigned distribution rate increases of only 27.5% and 16.2% to the RS and RTS classes, respectively.⁴⁹ Thus, PPL proposed that the residential classes receive less than the system average distribution rate increase, in spite of the fact that every cost of service study presented in this proceeding (including the OCA's) demonstrated that the residential classes are under-paying their cost of service at present rates.⁵⁰

The OSBA respectfully disagrees with the ALJ's conclusion that the "Company's proposed revenue allocation produces a reasonable result."⁵¹ Contrary to the ALJ's conclusion, the record evidence (summarized below) makes clear that the Company's revenue allocation does *not* produce a reasonable result:

- The Company's cost of service study concluded that the GS-1 and GS-3 classes are over-paying their cost of service at present rates.⁵² The OSBA cost of service study confirmed this conclusion.⁵³ Even the OCA cost of service study, which used an entirely different methodology to allocate the distribution plant costs,⁵⁴ showed that the GS-1 class is over-paying its cost of service at present rates.⁵⁵

⁴⁹ These results are set forth in OSBA Statement No. 1, Table IEC-7, at 26.

⁵⁰ See PPL Statement No. 5, Exhibit JMK-2, at 76, lines 30-31; OSBA Statement No. 1, Table IEC-1; at 14; Id., Table IEC-3, at 19; OCA Statement No. 4, Schedule RAG-1, at 1, lines 30-31.

⁵¹ RD, at 151.

⁵² See PPL Statement No. 4, Exhibit JMK-2, at 76, lines 30-31.

⁵³ See OSBA Statement No. 1, at 19, Table IEC-3.

⁵⁴ OCA witness Galligan proposed to eliminate completely the customer component of the secondary distribution costs, and to use the "peak-and-average" allocator for all primary and secondary distribution plant costs. See OCA Statement No. 4, at 16-20.

⁵⁵ See OCA Statement No. 4, Exhibit RAG-1, at 1, lines 30-31.

- The Company’s distribution service revenue allocation proposal assigned increases to the GS-1 and GS-3 classes that are greater than the 32.8% system average increase proposed by PPL. Specifically, PPL’s distribution revenue allocation scheme assigned a 35.8% rate increase to the GS-1 class (a class that even the OCA cost of service study concluded is already over-paying its cost of service), and a 51.2% rate increase to the GS-3 class.

The OSBA agrees with the ALJ that cost of service studies should not be the only consideration when allocating revenues to the Company’s customer classes.⁵⁶ However, the ALJ’s decision to recommend the PPL proposal implicitly concluded that the cost of service is not a consideration at all.

Consequently, and without contradiction in the record of this proceeding, the Company’s distribution revenue allocation proposal does not produce a “reasonable result.” *Instead, it produces discriminatory rates.* The ALJ’s recommendation to adopt the Company’s discriminatory distribution revenue allocation contradicts her own acknowledgement of case law affirming the prohibition on discriminatory rates and requiring a reasonable basis for any difference in rates from one class to the other.⁵⁷

The ALJ’s decision to recommend the Company’s discriminatory revenue allocation is apparently based in part upon the notion that because PPL’s last base rate case used a bundled cost of service study, it would be “inappropriate to move rapidly” to correct any distribution service inequities in this proceeding.⁵⁸ However, the fact that

⁵⁶ RD, at 144.

⁵⁷ RD, at 140.

⁵⁸ RD, at 147.

PPL presented a distribution-only cost of service study in this proceeding (with transmission service unbundled and assigned a specific surcharge mechanism) does not in any way hamper the Commission's ability (and duty) to correct the inequities contained therein. The Company's distribution cost of service study illustrated that the GS-1 and GS-3 customer classes are currently over-paying their cost of service. Furthermore,

... the Company's 1995 compliance filing cost of service study (following its last base rate case) showed that the commercial GS-1 and GS-3 customer classes were substantially over-paying their 'bundled' cost of service.

OSBA Reply Brief, at 15 (footnote omitted). Specifically, in the Company's 1995 cost of service study submitted with its compliance filing, the GS-1 class rate of return was 15.68 percent, the GS-3 class rate of return was 11.44 percent, and the system average rate of return was 9.54 percent. In contrast, the RS class rate of return was 7.65 percent.⁵⁹

Nevertheless, the Company proposal (which the ALJ recommended) takes two classes (GS-1 and GS-3) that were over-paying their bundled cost of service in 1995, and are over-paying their distribution cost of service in 2004, and assigns them a much larger than system average distribution rate increase. The ALJ's recommendation not only produces distribution rates that are discriminatory, but it also produces rates that cause economic harm to a wide segment of PPL's customers:

The Company's September 1995 bundled cost of service study documented that the commercial GS-1 and GS-3 customers were massively over-paying their cost of service. The Company's distribution cost of service study, presented in this case, showed that the GS-1 and GS-3 customers were, nine years later, massively over-paying their distribution cost of service. Logically, larger than system average rate increases must be allocated to all customer classes that are receiving a subsidy at present rates. *Just as logically, if the Company's small business*

⁵⁹ See OCA Statement No. 4, Schedule RAG-3.

customers do not receive rate relief in this proceeding, every single additional dollar that those businesses are forced to pay for electricity will result in fewer jobs, lower wages, and less generous benefits.

OSBA Reply Brief, at 5 (emphasis added).

The truth of this assertion was affirmed in the testimony in the public input hearings which the ALJ cited in the RD. As the ALJ observed:

[M]embers of the Pennsylvania Food Merchants Association appeared and testified . . . and . . . all of them will be hit hard by this increase.

RD, at 181.

In contrast to the Company's discriminatory distribution service revenue allocation proposal (which benefits the residential customer classes at the expense of business customers), the OSBA revenue allocation proposal is both reasonable and fair to all of PPL's customer classes. Contrary to the ALJ's statement, the OSBA proposal does not "skew" the distribution revenue allocation in favor of a particular subset of the Company's customers.⁶⁰ Instead, the OSBA proposal works to correct the undisputed inequities among the classes while recognizing that all rate increases must conform to the principle of gradualism. The OSBA's proposal is as follows:

- Assign the distribution rate increases for the transmission voltage customers as set forth in the Company's proposal;⁶¹

⁶⁰ RD, at 151.

⁶¹ Under PPL's revenue allocation proposal, the Company's transmission voltage customers receive a below system average distribution service rate increase. See OSBA Statement No. 3, Exhibit IEC-R2.

- Assign a greater than system average rate increase to those customer classes that are currently under-paying their cost of service (RS, RTS, and Street Lighting), but cap the rate increase for each of those classes at twice the system average on a total-bill basis;⁶²
- Assign a below system average rate increase to the remaining customer classes that are over-paying their cost of service (GS-1, GS-3, LP-4, GH) by spreading among those classes the additional revenue raised from RS, RTS, and Street Lighting.⁶³

The OSBA distribution revenue allocation proposal produces a reasonable result by moving the customer classes closer to their cost of service while simultaneously obeying the principle of gradualism. Therefore, the OSBA respectfully requests that the Commission reject the ALJ's distribution service revenue allocation recommendation and adopt the OSBA distribution revenue allocation proposal.

⁶² The OSBA proposal mirrors the Company's proposal by measuring the impact of any customer class rate increase on a "total-bill" basis. Restricting the maximum increase to twice the system average for any individual customer class is the OSBA's interpretation of the principle of gradualism. See OSBA Statement No. 1, at 28.

⁶³ The details of the OSBA proposal is included in OSBA Statement No. 1, Exhibit IEC-2 and OSBA Statement No. 3, Exhibit IEC-R1. The OSBA's proposal is compared to those of the other intervenors (excluding OTS, whose expert did not provide the specific implications of his proposal) in OSBA Statement No. 3, Exhibit IEC-R2. The proposal in Exhibit IEC-2 assumes the full proposed PPL revenue requirement, and would need to be scaled back to meet the ALJ's recommendations. Exhibit IEC-R1 shows the OSBA proposal at a reduced revenue requirement. Because the reduced revenue requirement in Exhibit IEC-R1 is lower than that recommended by the ALJ, it would need to be scaled up to meet the ALJ's recommendation.

6. The ALJ incorrectly recommended that any overall revenue decrease be proportionately scaled back among the customer classes. (RD at 148-149)

If the Commission does not approve the OSBA proposal to allocate the distribution service rate increase among the customer classes, then there are other ways to provide at least a measure of the “relief” which the ALJ found that the Company’s small business customers deserve.⁶⁴ The vehicle for this relief lies in the design of the scale back of PPL’s proposed revenue requirement to the level ultimately allowed by the Commission.

The ALJ apparently believed that a straight “proportional” scale back is the “fair way to reduce the increase.”⁶⁵ As explained *supra*, the majority of the Company’s rate structure proposals directly benefit the residential classes, frequently at the expense of PPL’s other customer classes. If PPL’s overall revenue requirement is set at something less than the Company originally requested, the ALJ’s recommendation to employ a straight “proportional” scale back of the original revenue requirement would simply continue the Company’s discriminatory revenue allocation.⁶⁶

The ALJ “did not see how” she could provide relief to PPL’s small business customers. However, relief could be provided by giving the RS, RTS, and Street

⁶⁴ RD, at 151.

⁶⁵ RD, at 148.

⁶⁶ It is well established that PPL carries the burden of proof in this proceeding. See 66 Pa.C.S. § 315(a). See also *Lower Frederick Twp. v. Pa. PUC*, 409 A.2d 505 (Pa. Cmwlth. 1980); *Brockway Glass v. Pa. PUC*, 437 A.2d 1067 (Pa. Cmwlth. 1981); and *Burleson v. Pa. PUC*, 501 Pa. 433, 461 A.2d 1234 (Pa. 1983) (“[t]he elements of that cause of action are proven with substantial evidence that enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary”). Therefore, the Company must produce evidence that a straight “proportional” scale back would yield a just and reasonable result for all customer classes and not continue to favor the RS and RTS customer classes, classes that all cost of service studies show are under-paying their costs at present rates. PPL has produced no such evidence.

Lighting customer classes the 9.7%, 9.9%, and 9.9% total-bill rate increases, respectively, originally proposed by the Company. By giving these three classes exactly what PPL proposed, the entire difference between the proposed revenue requirement and the approved revenue requirement could then be allocated to those customer classes that are presently over-paying their cost of service. That allocation could be implemented in proportion to each over-paying class' share of PPL's original proposed rate increase.⁶⁷

The Commission could also avoid the discriminatory effects of a straight "proportional" scale back of the original revenue requirement by setting the maximum distribution rate increase at the system average distribution for any customer class that is currently over-paying its cost of distribution service. The resulting shortfall between what those classes would pay under the straight scale back recommended by the ALJ and what they would pay at the system average distribution rate increase could be recovered from those classes (RS, RTS, Street Lighting) that are currently under-paying their distribution cost of service.⁶⁸

Therefore, as an alternative to the OSBA revenue allocation summarized in the preceding section, the OSBA respectfully requests that the Commission reject the ALJ's recommendation to "proportionally" scale back any decrease in the overall revenue requirement, and instead fashion a scale back solution that would provide rate relief for those customer classes that are currently over-paying their distribution cost of service.

⁶⁷ See OSBA Statement No. 1, at 28-29. See also OSBA Statement No. 3, at 27-28.

⁶⁸ Id. For simplicity, distribution rate increases for the transmission voltage customers could be assigned as set forth in the Company's original revenue allocation proposal.

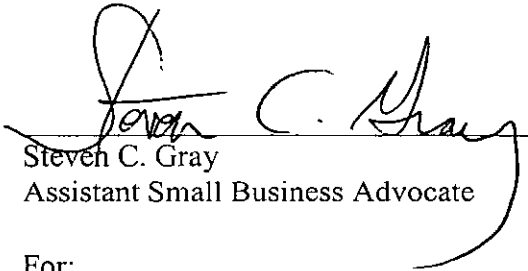
III. CONCLUSION

Wherefore, the OSBA respectfully requests that the Commission:

1. Reject the ALJ's recommendation to approve a DSIC mechanism after legislative input;
2. Reject the ALJ's recommendation to fund the SEF, and instead direct that funding to PEDDA, or, in the alternative, either
 - a. Initiate a separate proceeding to examine the operation, management, and fiscal responsibility of the SEF, or
 - b. Preserve the right of the parties to challenge the SEF in PPL's next distribution rate case, even if that case occurs before December 31, 2009;
3. If the Commission rejects the ALJ's recommendation to adopt the Company's original TSC proposal, adopt the OSBA proposal to allocate the PJM transmission charges;
4. Reject the ALJ's tacit recommendation to approve the "10% total-bill" benchmark as the proper measure of gradualism;
5. Reject the ALJ's recommendation to adopt the Company's revenue allocation, and instead adopt the OSBA revenue allocation proposal, or, in the alternative, reject the ALJ's recommendation to adopt a "proportional" scale back of rates, and instead, either
 - a. Allocate the entire decrease in PPL's proposed revenue requirement to those customer classes that are currently over-paying their cost of service, or

b. Set the maximum distribution rate increase at the system average for those classes currently over-paying their distribution cost of service and recover the remaining revenue from those classes (RS, RTS, and Street Lighting) currently under-paying their distribution cost of service.

Respectfully submitted,



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Dated: November 12, 2004

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

Docket No. R-00049255

PPL ELECTRIC UTILITIES CORPORATION :

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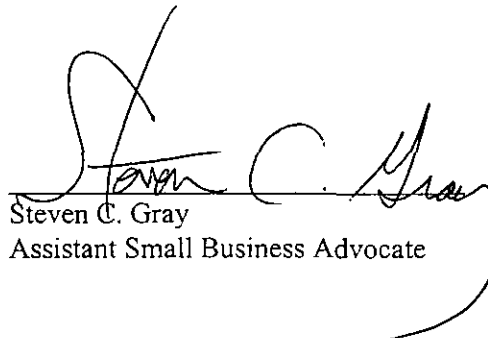
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

Docket No. R-00049255

PPL ELECTRIC UTILITIES CORPORATION :

CERTIFICATE OF SERVICE

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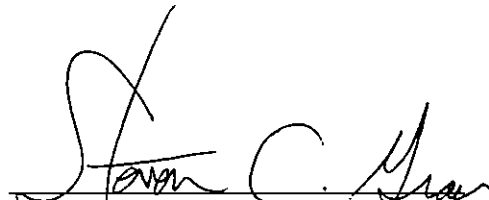
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COMMONWEALTH OF PENNSYLVANIA
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IN REPLY PLEASE
REFER TO OUR FILE

November 12, 2004

ORIGINAL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Pennsylvania Public Utility Commission v.
PPL Electric Utilities Corporation
Docket No. R-00049255

DOCUMENT

Dear Secretary McNulty:

Enclosed please find for filing an original and nine copies of the Exceptions of the Office of Trial Staff in the above-captioned proceeding. Copies have been served according to the certificate of service.

Respectfully submitted,

Johnnie E. Simms
Chief Prosecutor

Enclosure
cc: Parties of Record

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

Pennsylvania Public Utility Commission :

v. :

Docket No. R-00049255

PPL Electric Utilities Corporation :

EXCEPTIONS
OF THE
OFFICE OF TRIAL STAFF

SECRETARY'S BUREAU

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Johnnie E. Simms
Chief Prosecutor

Richard A. Kanaskie
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Office of Trial Staff
Pennsylvania Public
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P.O. Box 3265
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Dated: November 12, 2004

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I. INTRODUCTION

On March 29, 2004, PPL Electric Utilities Corporation (“PPL” or “Company”) filed Supplement No. 38 to Tariff Electric-Pa. P.U.C. No. 201 (“Supplement No. 38”) with the Pennsylvania Public Utility Commission (“PUC” or “Commission”). Supplement No. 38 proposed changes in distribution rates, rules and regulations designed to increase retail distribution rates by over \$164 million annually. The Company based its request on the use of future test year data ending December 31, 2004.

At the same time, the Company informed the Commission that the transmission rate would be increased by approximately \$57.2 million. The transmission charges arise under Federal Energy Regulatory Commission (“FERC”) regulated PJM¹ Open Access Transmission Tariffs (“OATT”) and are not the subject of this proceeding. The combined requested increase is over \$221.0 million representing an 8.1% increase to annual revenue.

On May 7, 2004 the Commission stated that, pursuant to 66 Pa. C.S.A. §1308(d), the filing would be suspended by operation of law effective June 1, 2004. The suspension was directed to remain in effect until January 1, 2005. An earlier effective date is not possible as PPL current operations include capped rates for both transmission and distribution. These caps will not expire until December 31, 2004.

¹ PJM is the power grid consisting of Pennsylvania, New Jersey and Maryland.

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The proceeding was assigned to ALJ Allison K. Turner for investigation and hearings culminating in the issuance of a Recommended Decision. The initial Prehearing Conference was held on May 19, 2004 at which time a litigation schedule was developed. A total of 9 Public Input Hearings were held throughout the Company's service territory.

Evidentiary Hearings were held in Harrisburg the week of August 9, 2004. During this week the testimony and exhibits of all active parties was entered into the record.² The record closed, by agreement of all parties, on August 13, 2004 generating a total of 1135 pages of transcript.

Main Briefs were filed by all interested parties on September 2, 2004 followed by Reply Briefs on September 13, 2004. On October 22, 2004 the Recommended Decision of the ALJ with the accompanied schedules were issued in this proceeding. The accompanied schedules which outlined the ALJ's recommended allowance was determined to be incorrect and an Errata Sheet was issued to correct the errors.

OTS hereby files Exceptions to certain findings of the ALJ including the accuracy of the Errata Sheet and the revised tables associated with the Recommended Decision.

² OTS entered the following testimony: The testimony of Kevan Deardorff including OTS St. No 1, OTS Exh. No. 1, OTS St. No. 1-SR, OTS Exh. No 1-SR. The testimony of Charles Weakley including OTS St. No. 2, OTS Exh. No. 2, and OTS St. No. 2-SR. The testimony of Joseph Kubas including OTS St. No. 3, OTS Exh. No. 3, OTS St. No. 3-SR and OTS Exh. No. 3-SR. The testimony of Paul Yarolin including OTS St. No. 4, OTS Exh. No. 4 and OTS St. No. 4-SR. The testimony of Michael Gruber including OTS St. No. 5, OTS Exh. No. 5 and OTS St. No. 5-SR. The testimony of Gary Yocca including OTS St. No. 6-R and OTS Exh. No. 6-R.

II. EXCEPTIONS

A. PRELIMINARY STATEMENT OF THE OFFICE OF TRIAL STAFF

1. The Supporting Tables (Corrected) Attached To The ALJ's Recommended Decision Are Incorrect And Are Unreliable As Support Of Her Recommendation.

The Office of Trial Staff ("OTS") was created by the Legislature in July of 1986 and charged with the responsibility of protecting the public interest. Specifically §306 of the Public Utility Code states that "[t]he Office of Trial Staff shall be responsible for and shall assist in the development of, challenge of and representation on the record of all matters in the public interest in all commission proceedings"³ with limited exceptions. OTS is the only party in the present proceeding with such a mandate. A review of the active party's involvement will indicate representation that affects the public interest, but it must be noted that each of these representations has a specifically defined constituency that stands to benefit from the outcome of the proceeding. OTS has no such limitation. As such, its positions and recommendations are not driven by a narrowly defined benefit to its client.

OTS views its responsibility to protect the public interest to include the requirement that, in all proceedings in which it participates, a complete and accurate record must be presented to the Commission in order that a reasoned and thoughtful decision can be rendered. OTS cannot overlook any errors as that

³ 66 Pa. C.S.A. §306(b)(1).

would violate its mandate of protecting the public interest. The public interest can only be protected and acknowledged through the presentation of accurate information to the Commission.

In this proceeding, OTS initially identified errors in the supporting tables presented in the Administrative Law Judge's ("ALJ") Recommended Decision which grossly overstated the recommended revenue allowance. Attempts to correct these errors resulted in the issuance of an Errata sheet by the Office of Administrative Law Judge ("OALJ").

A cursory review of the corrected tables attached to the OALJ Errata sheet reveals that this correction contains errors. The impact of these errors on the revenue increase recommended by the ALJ has not been determined as accurate calculation requires the input of many unidentified assumptions not clearly presented in the ALJ's decision. The recommended revenue increase of \$130,111,983 must be reevaluated as the supporting schedules are clearly inaccurate and do not support the ALJ's recommendation.

It is not necessary to look any further than Table I (corrected) to determine that the supporting schedules are inaccurate. The column entitled "ALJ Revenue Increase" reports an operating revenue increase of \$130,111,983. Operating expenses in this same column are listed as \$54,592,880 resulting in, as per the table, a net income available of \$71,027,788. However, a simple mathematical calculation reveals that the operating revenue less the operating expenses represented in this Table equals a net income available of \$75,519,103. The ALJ's

Recommended Decision does not provide sufficient guidance to determine if the operating revenue increase is overstated or if the operating expenses are understated or if the net income available is just incorrect. An accurate record for the Commission to review must include correction of this error.

A similar error is present in Table I (corrected) in the column titled "Total Allowable Revenues." This column reports operating revenue of \$654,784,983 and operating expenses of \$499,838,724. The resulting calculation for net income available is reported as \$150,454,944. This is clearly an error as, based on the inputs presented in the table, the net income calculation should yield a result of \$154,946,259. As is the case in the column titled "ALJ Revenue Increase" discussed earlier, the incorrect input is not readily apparent in the Recommended Decision. For these supporting tables to be of any use in this proceeding the inputs must be identified and corrected in order to present a verifiable calculation.

Continuing the review of the supporting tables and referencing Table I (B), titled the Revenue Factor, the ALJ has identified three entries that are subject to iteration in proper utility regulation. These entries include 1) uncollectible accounts expense; 2) Public Utility Commission ("PUC" or "Commission"), Office of Consumer Advocate ("OCA"), Office of Small Business Advocate ("OSBA") Assessments; and 3) Gross Receipts Tax. These entries identified for iteration are correct, however, Table I (corrected) incorporates only two adjustments. The first adjustment totaling \$852,233 appears to be the adjustment for uncollectible accounts expense. The second adjustment of \$181,609 is

identified on Table V (corrected) as the Pennsylvania Gross Receipts Tax. This is obviously incorrect. OTS contends that this error must be corrected before the Commission refers to these supporting tables. The fact that the Revenue Factor calculation includes three items for iteration but the Income Statement only reflects two items casts doubt on the accuracy of the tables offered in this Recommended Decision. In this scenario, either the entry titled "Taxes Other" is incorrect or the Revenue Factor is incorrect. Correction of these errors would require the input of assumptions not readily identifiable in the ALJ's Recommended Decision. As the intentions of the ALJ are unclear in this decision, correction of the schedules would require independent assumptions. These corrections need to be made on evidence presented in the record, not assumptions. This is critical in making a supportable determination as an incorrect Revenue Factor, if that is indeed the case, would directly impact the ALJ's recommended increase.

OTS contends that the above referenced errors are readily apparent examples of the errors included in the tables and the ALJ's calculations. However, these errors are not all inclusive because, due to time constraints and the lack of the assumptions used by the ALJ in her determinations, OTS could not evaluate all the tables associated with this Recommended Decision. OTS presents these findings as justification for issuance of new, correct schedules before any recommendation is reviewed. The Commission cannot accurately present adjustments based on a faulty premise. The spreadsheets attached to the

Recommended Decision are indeed faulty and of no value in evaluating the ALJ's decision.

OTS makes no recommendation as to the correction of these errors until the assumptions used in the calculations are clearly identified. Only when the assumptions used in the inputs are identified can the ALJ's recommendation be properly analyzed and the true impact of the recommended revenue increase be determined. Proper protection of the public interest requires an accurate review of the impact on all entities affected in a regulatory proceeding. Therefore, in accord with its legislative mandate, OTS will not make recommendations that cannot be supported by evidence and determinations that are not clearly present in the record or the Decision of the ALJ. Once the basis of the ALJ's determination is identified, the Commission can evaluate this proceeding in the proper perspective.

B. RATE BASE

1. The ALJ Improperly Accepted The Capitalized Portion Of The Company's Claimed Pension Expense.

OTS Main Brief, pp. 15-16.

OTS Reply Brief, p. 5.

Recommended Decision, p. 4.

Proper ratemaking principles require the capitalized portion of the Company's claimed pension expense be rejected. This adjustment reduces the Company's claimed Rate Base by \$613,000. Details of the proper analysis of this adjustment are contained in Section D, Expenses, subsection 1, Pension Expense, beginning on page 13.

C. REVENUE

1. The ALJ Erred In Accepting The Weather Normalization Presented By PPL.

OTS Main Brief, pp. 17-19.

OTS Reply Brief, pp. 6-11.

Recommended Decision, pp. 24-32.

The ALJ's initial error in this recommendation is her misapplication of the burden of proof in this proceeding. It is clear that the Company maintains the burden of proof throughout the entire proceeding. Another party raising an issue does not shift the burden of proof to that party. The ALJ's misguided instructions as to the filing of a Motion to Compel or Moving to Strike relevant testimony, along with being incorrect, demonstrate her misapplication of satisfaction of the burden of proof required in this proceeding. The ALJ's comment regarding a Motion To Compel suggests that she finds the Company's evidence lacking. As

for a Motion to Strike relevant evidence, there is no evidentiary basis to suggest that this would be appropriate. Relevant evidence is always admissible. The issue is whether the evidence is of sufficient probative value as to be useful to the Company in satisfying its burden of proof in this proceeding. Although it is clearly admissible, it should be given minimal weight as it is unsupported. The entire discussion surrounding the inability to provide certain data based on it being proprietary, or not available in Excel is precisely the crux of the Company's failure to bear its burden of proof in this proceeding. The Company has not placed, into the record, the necessary facts to support its claim with respect to this issue. The ALJ comments regarding Protective Orders and access to the PPL server along with the statement that "OTS should have been afforded an opportunity to test the use of this model somehow"⁴ further supports the Company's failure to prove its claim with substantial evidence. In essence, the ALJ is recommending that the Commission blindly accept the Company's model without the ability to independently test the projections produced by the model. Such a recommendation does not pass the weakest burden of proof test.

The ALJ bases her recommendation on her statement that "[t]he Company has obviously spent some time and money in developing the tools (METRIX ND and 20 years of data) with which it makes sales projections."⁵ She further opines "that the Commission should not tell it what projection tools to use."⁶ OTS

⁴ Recommended Decision, p. 26.

⁵ Id at 27.

⁶ Id.

respectfully submits that the ALJ's statement is a failure to understand that the Commission is in the business of informing utilities on what projection tools will be relied upon for ratemaking purposes. The ALJ further states that "[i]f the Company did not use these tools for presentation of its sales forecast in this case, but merely substituted the OTS methodology, then the Commission would not know how PPLEU goes about making its projections and reaching its decisions."⁷ The ALJ's recommendation is misguided as it attempts to elevate the Company's self-serving projection into the new standard for the Commission to follow. The ALJ's recommendation fails to recognize the inability of any party, including the Commission, to test the Company's model and verify its results or to even determine how the results were achieved. The ALJ mistakenly accepts the Company's proposition that this information cannot be made available to the parties, yet determines that it has satisfied its burden of proof with respect to this issue.

Nonetheless, there remain at least two clearly identified flaws that the ALJ refuses to recognize. First, the Company used only 20 years of data in its calculation. The ALJ rejects the finding that "[t]he Commission has traditionally utilized a 30-year average number of heating degree days in computing a weather normalization adjustment."⁸ The ALJ's reliance on the Company representation that use of revenue months will yield more accurate projection results is

⁷ Id.

⁸ Pennsylvania Public Utility Commission, Et al. v. Philadelphia Gas Works, 2000 Pa. PUC LEXIS 65 (2000). See also, Pa. P.U.C. v. National Fuel Gas Distribution Company, 83 Pa. PUC 286 (1994).

misguided. The individual differences between revenue months and calendar months is negated when the figures are annualized. If any differences remain, they would be so miniscule as to not skew the results. The Company chose its own model and supported it with its own choices. These choices are contrary to Commission policy and adopting this methodology is not in the public interest.

The second readily recognizable flaw in the Company's model is the use of data from a private firm instead of the widely accepted data provided, and published publicly, by the National Oceanic and Atmospheric Administration ("NOAA"). The ALJ asserts that the data is not massaged, yet readily acknowledges that the information received from this private firm has been "adjusted".⁹ The record indicates that this private firm, under contract with PPL, corrects what it considers to be erroneous data and inserts estimates for missing data. There is no record evidence supporting why the data has to be "corrected." Furthermore, the Company has not provided any evidence as to what data is erroneous and why, nor has it identified the missing data and the value that was inserted in its place. The ALJ readily admits that she does not know how the data has been determined in the comment that "[i]t is not even known if the Company has been using the service for 20 years."¹⁰ The ALJ erred in determining that the

⁹ Webster's Dictionary defines "adjusted" as follows: "accommodated to suit a particular set of circumstances or requirements." In the instant case, the ALJ, parties and Commission do not know the particular set of circumstances and requirements utilized by the private firm and PPL in producing the projections.

¹⁰ Recommended Decision, p. 29.

Company satisfied its burden of proof because she admitted that she is not sure how a key input to the Company's model was determined.

The ALJ incorrectly relies on the Company's normalized projected monthly usage of 1450 kWh by its residential heating customers in her recommendation. She determined this to be an appropriate weather normalized level in spite of the fact that there is no information in the record as to how the Company determined its calculation of 1450 kWh. A more reasonable level of monthly usage for residential heating customers is 1496 kWh as shown on OTS Exhibit No. 3, Schedule 8 (revised) column D, line 2. The basis for this recommendation is quite clear. OTS used actual historic usage data along with 30 year data readily obtained from NOAA in accordance with Commission practice. As projected monthly usage is a key component in a weather normalization calculation, an accurate projection is necessary in order to provide an appropriate adjustment. With any projection, if the inputs are flawed, the resulting calculation will be flawed. In this proceeding, OTS files this exception to the ALJ's recommendation as she relied on the flawed inputs in the Company's proposal.

Finally, any argument that traditional weather normalization procedures do not apply to the electric distribution industry is without merit. The purpose of weather normalization is to "restate historic test year actual sales on a per customer basis to the level of sales that the utility would have achieved had the

actual heating or cooling degree-days been normal.”¹¹ The model may make certain assumptions as to the type of utility but the inputs do not. A heating or cooling degree-day is the same in any industry. As such, flawed inputs in any industry will yield flawed results. That is the case in this proceeding.

The ALJ’s recommendation should be rejected and the increase to present rate revenue of \$3,065,000 shown on OTS Ex. No. 3, Schedule 8 (Revised) should be approved as it accurately calculates Company revenue based on an approved Commission methodology.

D. EXPENSES

1. The ALJ Improperly Allowed The Company To Recover A Claim For Pension Expense Based On The Accrual Method Of Accounting.

OTS Main Brief, pp. 22-24.

OTS Reply Brief, pp. 14-15.

Recommended Decision, pp. 63-66.

The Company’s claimed pension expense must be rejected as it violates sound ratemaking principles and provides a windfall to investors to the detriment of ratepayers. The ALJ’s recommendation requires continued contributions from ratepayers where no actual contribution to the pension fund will be made by the Company. The ALJ’s misguided reliance on accounting principles must be

¹¹ OTS St. No. 3, p. 3.

rejected and the cash contribution method utilized in two recent rate cases must be adopted.¹²

Sound ratemaking mandates that funds be recovered from ratepayers only if there is an actual pension fund contribution associated with the claim. In this instance, the Company has not demonstrated with substantial evidence that it will contribute the \$1,396,976 that it will collect from ratepayers into its pension fund. As the record will support, pension contributions are based on Employee Retirement Income Security Act ("ERISA") minimums and Internal Revenue Service Code ("IRS") maximums. Both of these guidelines for the test year are zero indicating that the Company will not be making a tax deductible contribution to this fund. As a result, the ALJ's recommendation will benefit only shareholders.

The ALJ's reliance on the Company assertion that it has a \$75 million liability that must be paid in cash in the future underscores the misunderstanding of accounting principles and regulatory principles. The liability claimed by the Company is nothing more than its accounting treatment of this claim. The liability claimed is the result of the fact that the Company has not made a cash contribution to its fund since the last rate case. However, they have continued, for book purposes, to record the expense. In other words, the liability claimed is the difference between what they have recorded on the books and what they have

¹² See, Pa. P.U.C. v. Aqua Pa, Docket Number R-00038805, Pa. P.U.C. v. Pennsylvania-American Water Company, Docket Number R-00038304.

contributed to the fund. The only way this liability will be reduced is by making actual cash contributions to the pension fund. As the Company's pension fund contributions are guided by ERISA minimums and IRS maximums, no contributions will be made. As such, no reduction to its proclaimed liability will be achieved. As a result, investors will be rewarded with an additional \$1,396,976 courtesy of the ratepayers. It is disingenuous, if not corporate malfeasance, to offer as support of your claim a purported liability of \$75 million while acknowledging receipt of \$10 million per year in ratepayer funds since the last rate case in 1995. Had the ratepayer funds that had been collected for the pension fund actually been contributed, or escrowed, there would be no liability. In fact, a surplus of funds would still have been collected from ratepayers for the benefit of shareholders. The Company has not been prohibited from making contributions. They have chosen not to as these contributions would not have been tax deductible. The ALJ's recommendation endorses this practice by concluding that it should continue. This recommendation comes despite the Commission Order in the Aqua Pa. rate case accepting the cash contribution method presented in that proceeding. The ALJ's reliance on the rationale that they were not contested is illogical and misguided. The recommendation suggests that because the methodology presented by Aqua Pa. was correct and only the amount necessary to contribute was in question this decision has no value. In other words, no one disputed the correct methodology and the Commission issued an Order approving the result, but it should be ignored in this proceeding. Furthermore, whether PPL

is a vertically integrated Company as in its last rate case or a stand alone distribution company as presented here is of no consequence when determining the proper regulatory treatment of this claim. For the ALJ to opine that OTS has not shown any changed circumstances in support of its position is irrelevant. The regulatory treatment of a claimed pension expense does not vary by type of utility.

The ALJ's recommendation should be ignored and the Company's claim should be denied in accordance with sound ratemaking policies. Two separate adjustments are needed to correct the ALJ's error. The Company's expense claim of \$1,396,976 must be rejected and the corresponding capitalized portion of the expense totaling \$613,062 must be removed from rate base.

2. The ALJ Erred By Recommending Ratepayer Contributions To A Social Program.

OTS Main Brief, pp. 27-28.

OTS Reply Brief, pp. 18-19

Recommended Decision, pp. 76, 172-173.

The ALJ's recommendation mandates the use of ratepayer contributions to fund a social program. Ratepayer contributions to the Community Betterment Initiative proposed by the Company should be rejected as the program does not satisfy the fundamental ratemaking principle o that the utility identify a direct benefit to ratepayers in order to recover an expense in rates.¹³ This claim presents no fundamental difference than the offerings in the Company's last base rate case that were appropriately rejected by the Commission. In the Company's 1995 base

¹³ Pennsylvania Public Utility Commission v. Consumers Pennsylvania Water Company – Roaring Creek Division, 87 PA PUC 826, 841 (1997).

rate case the Commission rejected the proposal for ratepayer funding of “Build-A-Neighborhood”; “Affordable Housing”; and “Small Business Programs.” The Commission stated that:

[t]hese socio-economic programs, to the extent they do not provide demonstrable benefits in light of costs to PP&L’s customers, are socio-economic decisions concerning the kind and extent of subsidies for needy customers in service territories that should be left to the legislative branch of the government. Such purely socio-economic decisions, devoid of any demonstrable cost benefit to a utility’s customers, are not the appropriate role for this Commission.¹⁴

In this same decision the Commission also stated that:

[w]hile we believe the shareholders, if they so choose, can fund any and all social programs of their choice, we believe that Commission-sanctioned funding is not appropriate when there is no demonstrable benefit to PP&L’s customers.¹⁵

In the present proceeding the Company has not demonstrated, with substantial evidence, that this program is any different than the programs offered in its last base rate case. They were identified as social programs in the past and this offering is no different. As a social program and absent proof of a demonstrable benefit to ratepayers, this claim must be rejected. The benefit offered in support is speculative and duplicative. The Company’s weatherization program and Customer Assistance Programs (“CAP”) already provide more focused benefits. Contributing ratepayer funds so community based organizations can leverage

¹⁴ Pennsylvania Public utility Commission v. Pennsylvania Power and Light Company, 85 Pa. PUC 306 (1995).

¹⁵ Id.

matching funds from the state for programs targeted in economic development and affordable housing violates the standards endorsed by this Commission.

The ALJ erred in failing to recognize that this claim supports a social program and has no direct benefit to ratepayers. This error must be corrected and \$1,000,000 be removed from the Company's operation and maintenance ("O&M") claim. However, the Company's offer to contribute \$1,000,000 of shareholder funds should be accepted as it will accomplish the goal of qualifying for matching funds as referenced in the Company's Main Brief and the Recommended Decision on page 172. This is consistent with the Commission's Order in the last base rate case *permitting shareholders to support any and all social programs*. Because the Company views this initiative as worthwhile, its contribution of \$1,000,000 of shareholder funds should be made.

3. The ALJ Improperly Accepted The Company's Claim For The Mandated Contribution Of Ratepayer Funds For The Financing Of The Operation Of The Sustainable Energy Fund.

OTS Main Brief, pp. 33-37.

OTS Reply Brief, pp. 20-21.

Recommended Decision, pp. 77-88.

The ALJ's recommendation to shift funding of the Sustainable Energy Fund ("SEF") to ratepayers is improper and must be rejected. Furthermore, the ALJ misinterpreted the issue in this proceeding and based her analysis on an incorrect premise. The issue is not whether SEF is a worthwhile program. In fact,

OTS supports the overall objectives of SEF¹⁶ and has stated so. The issue is whether it should be mandated that PPL's ratepayers be responsible for funding this entity after December 31, 2004.

The magnitude of this issue cannot be understated. This is the first, post rate cap, distribution case to come before the Commission. As such, it is the first proceeding to mandate a shift in funding from the Company to its ratepayers. Funding for the SEF came as a result of the Restructuring Proceeding.¹⁷ Although the source of the funding was not explicitly stated in that proceeding, it is undisputed that rates were not changed after Restructuring and the Company did not create an expense for the funding of this proposal. Any argument that ratepayers have been funding this program since its inception is contrary to the facts in evidence. The Company proposal in this proceeding is that the previously agreed to expiration of the funding should be continued and that it should now be borne by ratepayers. Therefore the issue is not the legitimacy of SEF, but the mandate that ratepayers fund this private entity.

The standard by which use of ratepayer funds is permissible is well established and indisputable. In order for the Commission to mandate ratepayer contributions to this private entity, as per the Company proposal, it must be demonstrated, by substantial evidence, that the ratepayers will receive a

¹⁶ The objectives of SEF have been described by the Company in the following statement: "[t]o promote the development and use of renewable energy and clean energy technologies, energy conservation and efficiency which promote clean energy." PPL St. No. 7, p. 22.

¹⁷ Application of Pennsylvania Power & Light Company for Approval of Restructuring Plan Under §2806 of the Public Utility Code – Docket No. R-00973954.

demonstrable benefit as a result of this requirement. This is the same standard utilized in analyzing social programs and there is no reason to create a different standard in this proceeding. The ALJ correctly established that “PPL retains the undivided burden of proof on this matter.”¹⁸ A review of the record evidence will indicate that the Company failed to provide *any* evidence, much less the legal standard of *substantial* evidence, to support its claim that *distribution* ratepayers will receive demonstrable benefits from the activities of this fund. OTS contends that if ratepayers are required to contribute to a fund that fails to provide a demonstrable benefit, but supports a broader, social initiative, it is akin to a hidden tax. The ALJ failed to acknowledge that OTS agrees that SEF is not hidden.¹⁹ It is the mandatory funding that is hidden. Furthermore, the ALJ opines that “[t]he tax argument must be based on the transfer of ratepayer money to another enterprise, other than the utility itself for utility function.”²⁰ The facts in this proceeding support this very statement as SEF is an enterprise other than PPL. The ALJ recommends transferring ratepayer money to another enterprise by recommending the Company’s proposal. The ALJ incorrectly dismisses an argument that is supported by her own recommendation. It is well established that the Commission lacks the authority to tax ratepayers.²¹

¹⁸ Recommended Decision, p. 82.

¹⁹ OTS Reply Brief, p. 21. Inexplicably, the ALJ ignores the argument of OTS wherein it was stated on page 21 that “[t]he fact that it is not clearly identified on ratepayers bills and most are probably not even aware of its existence, one must conclude that it is hidden. OTS would agree that SEF is not hidden....The mandatory funding is what OTS characterizes as “hidden” as it is for a program that lacks discernable benefits to distribution system ratepayers.”

²⁰ Recommended Decision, p. 81.

²¹ See, PPLICA Main Brief, pp. 13-17.

Furthermore, the record evidence contradicts the need for the mandated ratepayer funding of this initiative. The Company stated, as the ALJ noted in the Recommended Decision, that “[SEF] is well run and has a strong balance sheet.” The ALJ supports the premise that SEF’s funding needs are questionable in her recommendation that “consideration could be given to setting declining amounts, so that at the end of five years, or by December 31, 2009, funding will have ended.”²² The ALJ’s recommendation contradicts her own findings by incorrectly concluding a benefit to ratepayers, noting the strong balance sheet of SEF and then recommending that the fund be terminated, on a declining basis, in five years. It’s one or the other. Either there is a benefit and it becomes permanently embedded in rates and is subject to review at each rate case, or as is the case in this proceeding, the Company fails in its burden to establish a demonstrable benefit to ratepayers thereby eliminating the proposed mandated funding by ratepayers. Furthermore, the ALJ’s declining amount recommendation must be dismissed as it represents a new position in this proceeding that no party has had an opportunity to explore and it is inconsistent with her findings.

OTS maintains its objection to ratepayers being required to fund a private organization. Interestingly, “the ALJ agrees with this basic principle.”²³ OTS continues to support the alternative presented by PPLICA allowing for ratepayers to make voluntary contributions to this fund. A review of the ALJ’s

²² Recommended Decision, pp. 87-88.

²³ Id. p. 87.

recommendation will show that this alternative is superior because it continues funding indefinitely, regardless of the Company's balance sheet and mission statement, and gives ratepayers the ability to choose to support this initiative. The ratemaking requirements will no longer be necessary as ratepayers will be free to choose to participate in SEF funding in contrast to the Company's stark mandate that they must contribute, whether there is a benefit or not.

Acceptance of the ALJ's recommendation will also require that ratepayers of different utilities be treated differently. This recommendation that PPL's ratepayers fund this initiative differs from the requirements of other electric distribution utilities. *In other words, the ALJ's recommendation requires PPL customers to pay for the SEF, but no similar requirement is present in the record for PECO customers or West Penn customers or any other electric distribution utility operating in Pennsylvania.* The ALJ's recommendation creates a scenario where funding becomes regional. A more appropriate recommendation would require programs such as this to be operated on a statewide basis in order to eliminate inequalities in funding mechanisms for each utility in Pennsylvania.

By allowing ratepayers to choose whether they want to participate in this program and ensuring that funds are utilized in a manner consistent with statewide energy goals lends support to the OSBA proposal of funds being maintained by a government agency.²⁴ Allowing a private entity to receive funds for regional use

²⁴ OSBA has recommended that any new funds be transferred to the Pennsylvania Energy Development Authority ("PEDA"). OTS endorses this position should the Commission find continued funding appropriate.

is inconsistent with the State's objective and provides another reason for dismissal of the Company's proposal.

The ALJ erred in recommending that SEF funding be transferred to ratepayers. This recommendation is contrary to sound ratemaking principles and must be rejected.

E. RATE OF RETURN

1. The ALJ Erred In Recommending A Return On Equity Calculation Using Improper Dividend Growth Projections.

OTS Main Brief, pp. 43-61, 52-53.

OTS Reply Brief, pp. 24-32, 29-30.

Recommended Decision, pp. 94-122, 117.

The ALJ's recommendation of an 8.20% overall rate of return based on a 10.25% return on common equity is overstated and must be rejected. Although conceptually correct in basing the recommendation on the result derived from the Discounted Cash Flow analysis ("DCF") as applied to a barometer group of electric companies, the ALJ erred in the application of this method as she accepted results based on faulty inputs. The ALJ's recommendation relied solely on the Department of Defense ("DOD") DCF analysis that used a growth rate derived from Value-Line's five year expected dividend growth. Apparently this recommendation was based, at least partly, on the belief that this calculation was acceptable "as neither the Office of Consumer Advocate ("OCA") nor OTS criticized the methodology."²⁵ A review of the evidence in the record indicates

²⁵ Recommended Decision, p. 122.

that the ALJ's assumption is incorrect as OTS witness Deardorff has testified extensively about the use of dividend growth rates in the DCF calculation. Using the Company witness as an example, Mr. Deardorff demonstrated in his Surrebuttal Testimony that the dividend growth rates used were based on flawed data. Both the Company witness and the Department of Defense witness used growth rates that are suspect as it was based on the same faulty data. As both witnesses used the same flawed premise, a discussion of one necessarily includes the other. The data used by these witnesses, based on Value Line projections, is questionable as evidenced by the testimony of Mr. Deardorff where he stated:

[t]he forecasts that Value Line's methodology is producing are suspect. Two examples will illustrate this point. As a first example, consider Value Line's five year dividend forecast for Duquesne Light of -4.0%. Value Line's data base shows that dividends paid in 2003 were \$1.00 and are expecting to pay \$1.00 in 2004 and to increase to \$1.04 in five years. The data clearly shows an incremental increase in the future but Value Line's perverse methodology of factoring in a decrease that occurred in 2002 clearly distorts the forecast into a negative number.²⁶

The evidence in the record contains further examples of faults in the Value Line calculation of forecasted dividend growth rendering its use unreliable. OTS witness Deardorff further testified that:

Value Line forecasted a dividend growth rate of 35 percent for PEPCO in the March 25, 2004 issue but later lowered this forecast to 16 percent in the June 4, 2004 issue. The fact that these two forecasts are based on the same identical set of dividend cash flows makes either result questionable. Second, the calculations are based on an assumption that PEPCO

²⁶ OTS St. No. 1-SR, p. 5.

only started paying dividends after the merger of PEPCO and Conectiv on August 1, 2002. Value Line's growth rate calculations were based on PEPCO shareholders receiving dividends of \$0.00 in 2001, \$.42 in 2002, and \$1.00 in 2003. The actual records show that PEPCO shareholders received dividends of \$1.00 in 2001, \$1.00 in 2002, and \$1.00 in 2003. Any calculations based on this clearly factual error will definitely yield useless results.²⁷

These obvious flaws in Value Line's projection enable the rate of return witnesses using these inputs to calculate inflated growth rates. These inflated growth rates based on faulty data distort the results of their DCF calculations.

While Mr. Deardorff submitted his criticism of the use of Value Line projected five year dividend growth in response to the testimony of the company witness the analysis applies to the recommendation of DOD's witness as his results were calculated using the same faulty inputs.²⁸

Application of the proper growth rates to DOD's analysis yields a more realistic DCF result that supports a cost of common equity recommendation of 9.3%. Use of the extreme rate of 5.5% as offered by both the DOD and Company witnesses is not even supported by the financial reporting institutions. The only way to achieve such an inflated growth rate is to include the distorted growth rate of PEPCO. Furthermore, this growth rate can only be achieved by using stale data. Updating PEPCO's growth rate from the outrageously distorted 35% to 16% as reported in later publications affects the projections of these witnesses.

However, neither witness has demonstrated, on the record, that they have injected

²⁷ Id., pp 5-6.

²⁸ See DOD Ex. KLK-5, KLK-6.

the most current data into their analysis when offering their recommendation. Instead, they rely on the inaccuracies of stale data supporting their inflated rate. The ALJ continues this error by acknowledging and recommending that this input be adopted in determining the DCF results to be used in this proceeding.

OTS witness Deardorff consistently uses consensus earnings forecasts in his DCF calculations. Earnings forecasts are better predictors of growth and, therefore, a better proxy for the growth component in the DCF model.

The ALJ's recommendation, although based on the correct methodology, must be adjusted to compensate for the flawed growth calculations proposed by both the Department of Defense and the Company.

F. MISCELLANAEIOUS ISSUES

1. The ALJ Erred In Recommending That The Transmission Surcharge Be Reconcilable.

Transmission costs are a known and measurable expense based on FERC approved tariffs and should be treated as any other expense. These costs can be forecast in the same manner as other expenses that the Company will incur thereby eliminating the need for special treatment.

The ALJ's interpretation of the law is misguided and her reference to Section 2806(e) of the Code is irrelevant.²⁹ Section 2806(e) does not have any bearing on whether an expense is reconcilable. The section merely restates the required contents of restructuring plans. Included in this section is the

²⁹ 66 Pa. C.S.A. §2806(e), Recommended Decision, p. 131.

requirement that unbundled prices for jurisdictional transmission must be included. Just because an expense has been unbundled does not automatically make it reconcilable. Relying on this section of the Code as support for recommending that an expense be reconciled is baseless.

Furthermore, the ALJ has misstated the position of OTS witness Yocca and inappropriately offers it as support of her recommendation. The ALJ statement that “OTS also produced another witness, Gary Yocca, who supported the reconcilable TSC”³⁰ is factually incorrect. The ALJ compounds this error by isolating one statement of this witness and distorting it into an incorrect premise. Relying on the testimony of Mr. Yocca wherein he stated that he “recommend[s] that the TSC as proposed by PPL be approved on a kWh basis” and interpreting that comment as support for a reconcilable TSC is a misinterpretation or a failure to understand his testimony. Only by taking this statement out of the context of his testimony could you even attempt to reach the conclusion that this witness supports reconciliation of this expense. Further magnifying the ALJ’s misinterpretation of the witness’s testimony is her comment that “[u]nfortunately, OTS did not choose to rely on him.”³¹ OTS did indeed choose to rely on Mr. Yocca’s testimony as it pertained to Mr. Baron’s proposal to reallocate the transmission charge among the various classes.³² In contrast to the ALJ’s recommendation, OTS relied on his testimony in the context of the subject matter

³⁰ Recommended Decision, p. 131, footnote 27.

³¹ *Id.*

³² See OTS St. No. 6-R.

it was addressing. Mr. Yocca did not testify as to whether the charge should be reconcilable, Mr. Gruber did and he offered no such comment in his testimony. The ALJ's attempt to create discord among the OTS witnesses is without merit and should be ignored.

Case in point, PPLICA Statement No. 1, Table 3, reveals that Mr. Baron proposed that for the recovery of the PJM transmission charges, some customers should be charged on kWh basis, and some on a demand and kWh basis.³³ In the rebuttal to Mr. Baron's proposal, Mr. Yocca recommended that the transmission charges as proposed by PPL be approved on a kWh basis. Simply put, if Mr. Baron had not made his proposal, Mr. Yocca would not have filed any testimony in this proceeding regarding transmission charges. The ALJ has unnecessarily commingled the issue of whether the recovery of transmission charges should be solely on a "kWh basis" *or* "demand and kWh basis" with the issue of whether the *recovered transmission charges from ratepayers*³⁴ should be "reconciled," they are separate and distinct issues, and must be decided by the Commission as separate issues.

The issue is clearly whether a FERC approved transmission cost is the type of expense that requires reconciliation. Any attempt to characterize these charges in a similar vein as commodity charges that may fluctuate wildly is without merit and should be rejected. The Recommended Decision unnecessarily addresses the

³³ See PPLICA Statement No. 1, pages 24-26.

³⁴ Either using kWh basis or kWh and Demand basis

risk encountered by every utility providing a service to the public. This expense is a normal aspect of doing business and should not be reconcilable.

G. RATE STRUCTURE

1. The ALJ's Recommendation Does Not Adequately Address The Significant Rate Subsidies Present Throughout The Company's Revenue Allocation.

OTS Main Brief, pp. 68-72.

OTS Reply Brief, pp. 36-37.

Recommended Decision, pp. 140-151.

The ALJ's recommended revenue allocation cites of all the key aspects of a proper design in its proposed adherence to the theories of gradualism and rate shock but falls woefully short in its application. The ALJ as much as admits the flaws in her recommendation when she states that she "would like to see some relief given to small business consumers of PPLEU's distribution service."³⁵

The ALJ mistakenly relies on the OCA endorsement of the Company's proposed revenue allocation in her recommendation. Inherent in the Company's proposal is its self imposed limitation as to the percentage increase to be given to any rate class. Unfortunately the ALJ endorses this as a laudable goal while ignoring the severe subsidies that remain as a result of this understated allocation. There can be no surprise that the OCA would endorse the Company proposal as it distorts the amount of increase that needs to be borne by residential customers. Included in that low increase is the fact that rate schedule RS still lags 40% behind

³⁵ Recommended Decision, p. 151.

the system average rate of return while rate schedule RTS maintains an astonishing negative rate of return.

Accomplishing the objectives of the Company's proposal, by its very nature, comes at a price to the other rate classes. A cursory review of the Company's proposal highlights the fact that rate class GS-1 and GS-3 are actually saddled with an increase to its already overstated system average rate of return. In other words, the ALJ recommends that it is perfectly acceptable to have these classes, consisting of primarily small businesses, absorb the costs of continuing the subsidy of the residential class. Similar subsidies remain in other rate classes.

OTS maintains that the recommendations contained in the testimony of its expert witness address the subsidies present in the Company's proposal while protecting the longstanding principles of rate shock and gradualism.³⁶ However, rate shock and gradualism are matters of interpretation and cannot be applied absolutely. Each rate class must be moved toward its system average rate of return in order to establish equitable rates in accordance with proper utility regulation. Advocating a narrowly focused proposal to the detriment of already overcharged rate classes violates the public interest and is contrary to an equitable approach to allocating the revenue increase granted in this proceeding.

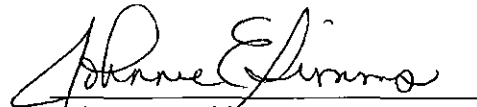
³⁶ The OTS proposal is explained in detail in OTS St. No. 4, and St. No. 4-SR. An update based on the current ALJ recommendation suggests that, for example, rate schedule RS should receive an increase of \$60,878,400 plus 49.85% of anything in excess of \$101,464,000 or \$14,281,019. Based on the ALJ recommendation the overall increase to rate schedule RS would be \$75,159,419. Subsequent reductions to the allowed revenue increase would result in an adjustment to the residual increase portion of the OTS recommendation.

OTS files this exception to the recommended revenue allocation as it unjustly continues the severe subsidies present in the Company's revenue allocation.

III. CONCLUSION

For the reasons set forth herein, the Office of Trial Staff respectfully requests that the Commission grant the aforementioned OTS Exceptions to the Recommended Decision of the Administrative Law Judge.

Respectfully submitted,



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Dated: November 12, 2004

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November 12, 2004

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VIA HAND DELIVERY

**Re: Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation
Docket No. R-00049255**

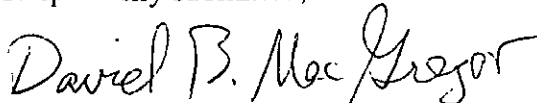
Dear Secretary McNulty:

Enclosed, for filing, are the original and nine (9) copies of the Exceptions of PPL Electric Utilities Corporation in the above-referenced proceeding.

As indicated on the enclosed certificate of service, copies have been served on all parties.

A copy of the Exceptions have been provided to the Commission's Office of Special Assistants on a 3 1/2" computer disk in Microsoft Word 6.0 format.

Respectfully submitted,



David B. MacGregor

DBM/jl

Enclosure

c: Certificate of Service

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission,
et al.

v.

PPL Electric Utilities Corporation

Docket Nos. R-00049255, *etc.*

DOCKETED

NOV 23 2004

EXCEPTIONS OF PPL ELECTRIC UTILITIES CORPORATION
TO THE RECOMMENDED DECISION OF
ADMINISTRATIVE LAW JUDGE ALLISON K. TURNER

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I. INTRODUCTION

On March 29, 2004, PPL Electric Utilities (“PPL Electric” or the “Company”) filed with the Pennsylvania Public Utility Commission (“PUC” or the “Commission”) a proposed distribution rate increase of \$164.4 million, and, at the same time, notified the Commission of an anticipated increase in transmission service charges of \$57.2 million. Combined, these two rate changes (\$221.6 million) represent an increase in total rates of 8.1%. The distribution increase was allocated to customer classes based on the results of a class cost of service study with the condition that no rate schedule would receive an average increase of more than 10% in total rates. The increase in transmission service charges was allocated to all customers on a uniform per kWh basis. As part of this filing, the Company also proposed to establish two automatic adjustment clauses, a Transmission Service Charge (“TSC”) to recover transmission costs incurred by the Company as the provider of last resort for generation services, and a Distribution System Improvement Charge (“DSIC”) to recover the carrying charges on certain distribution system improvements made between base rate cases.

The proposed rate increase was thereafter suspended by operation of law until January 1, 2005, and the matter was assigned to Administrative Law Judge Allison K. Turner (“ALJ”) for hearings and issuance of a Recommended Decision (“RD”). After extensive discovery, hearings and briefing, the ALJ issued her RD on October 23, 2004. The RD proposed a distribution rate increase of \$130.1 million, approved the \$57.2 million increase in FERC-approved transmission service charges, approved the TSC and rejected the DSIC, as filed. In accordance with the schedule established by the Commission, PPL Electric files its Exceptions to the RD.

As an initial matter, it should be recognized that the ALJ prepared a comprehensive and well reasoned RD. Although PPL Electric does not agree with all aspects of the decision, the ALJ clearly devoted substantial time and attention to each of the many issues presented and correctly decided most of the major issues in this case.

There are two significant issues, however, where PPL Electric does not agree with the RD. The first is the ALJ's proposed 10.25% return on common equity capital. As the ALJ makes clear in her decision, this 10.25% recommendation is based solely on an unadjusted discounted cash flow ("DCF") analysis. The Commission, however, has repeatedly held that the unadjusted DCF approach understates the cost of equity. To address this shortcoming, it is essential to adjust the DCF result to reflect the difference between the market and book value of a utility's stock and/or to consider other methods, *i.e.*, risk premium or CAPM, in determining the cost of equity. The RD did neither and, as a result, proposed a cost of common equity that is inconsistent with recent decisions of this Commission establishing a 10.6% cost of common equity for less risky water utilities; inconsistent with the average cost of equity allowance in other jurisdictions (11% in 2003, a time of relatively lower interest rates); inconsistent with the 10-12% expectation of the capital markets; and which fails to recognize PPL Electric's excellent management effectiveness. PPL Electric believes that the record in this case fully supports an 11.5% return on common equity.

The second major issue relates to the DSIC. The RD generally supports a properly designed DSIC, but expresses some concern as to the Commission's statutory authority to approve a DSIC, and concludes that PPL Electric has not demonstrated a clear need for a DSIC. As fully explained in PPL Electric's Initial and Reply Briefs, the

Commission clearly has the existing statutory authority to establish DSICs, and the Commission has consistently so held. Moreover, PPL Electric presented extensive evidence as to its need for a DSIC to help support replacement of its aging inventory of poles and wires, which will require capital expenditures in excess of \$900 million over the next five years.

In reviewing this case, it also is important that the Commission place this proceeding in its proper context. First, this case is an important next step in the restructuring of the electric utility industry in the Commonwealth. This case is the first base rate case filed by a major Pennsylvania electric utility since the industry was restructured. This case has been closely monitored by interested parties across the country, and the Commission's decision will send an important signal about Pennsylvania's continued commitment to electric restructuring.

Second, this case is critical to PPL Electric's financial future and its ability to continue providing reliable service to its customers. Due to increasing costs, a growing capital budget and lengthy rate caps, PPL Electric's financial condition has deteriorated significantly in recent years to the point that it earned a return on common equity of less than 2% in 2003, as compared to the 11.5% allowance approved by the Commission in the Company's last base rate proceeding in 1995. As a result, PPL Electric's current debt rating is A minus, with a "negative outlook." Without substantial rate relief, it is uncontested that PPL Electric will lose its already weak A minus rating. This financial deterioration comes at a time when the Company is facing significant capital requirements to replace and upgrade an aging infrastructure. Adequate rate relief is

essential to the Company's ability to attract sufficient capital to finance these improvements and thereby continue to provide reliable service to customers.

Third, the un rebutted evidence in this case demonstrates PPL Electric's overall management effectiveness and efficiency. The ultimate test of management effectiveness is its ability to provide reliable and efficient service at reasonable rates. PPL Electric has met and exceeded expectations under any reasonable standard. The Company's rates essentially are the same as they were in 1986 and remain well below national, Pennsylvania and regional averages. And, while maintaining rate stability, the Company has won numerous industry awards for quality of service and customer satisfaction.

Finally, it is important to recognize that PPL Electric has made every reasonable effort to limit its proposed rate increase to the absolute minimum necessary for it to attract capital on reasonable terms and provide reliable service to its customers. Despite operating under essentially the same rates for the past 19 years, while undergoing a fundamental restructuring of its business and making major capital investments to improve service, PPL Electric has limited its proposed increase to just over 8%, and roughly 25% of that amount is simply a flow through of increased FERC-approved transmission service charges. A modest 8% increase, after almost 20 years of rate stability, is clearly reasonable under any standard and should be approved.

II. EXCEPTIONS

PPL Electric respectfully excepts to the following recommendations of the ALJ:

1. The ALJ incorrectly determined the cost of common equity to be 10.25% based solely on an unadjusted DCF model.
2. The ALJ failed to reflect retained earnings for 2004 in the capital structure.

3. The ALJ erroneously rejected the Distribution System Improvement Charge as filed.

4. The ALJ used an improper method to calculate Capital Stock Tax.

5. The ALJ incorrectly adjusted Service Corporation charges.

6. The ALJ recommended denial of recovery of certain expenses caused by the automated meter reading system.

7. The ALJ improperly reduced storm damage expense from Hurricane Isabel and extended the amortization period to ten years.

8. The ALJ's recommendation on traffic lighting should be clarified that PPL Electric is not required to offer unmetered service or rebates.

9. The ALJ erroneously recommended reduced funding for PPL Electric's Customer Assistance Program.

10. The ALJ's recommended Transmission Service Charge is incorrect.

III. ARGUMENT

A. RATE OF RETURN

1. Introduction

a. The Importance Of The Rate Of Return Decision In This Proceeding

This proceeding is the first major distribution base rate proceeding following expiration of the transmission and distribution rate cap under the Electricity Generation Customer Choice and Competition Act ("Competition Act") 66 Pa.C.S. Ch. 28. It is the first base rate proceeding for PPL Electric since 1995, nearly ten years.

This case and the return on equity ("ROE") determination in this case, in particular, are being watched closely by the capital markets. This case is the first major Pennsylvania rate case following electric restructuring and one of the first in the nation.

Pennsylvania regulation currently is viewed by the capital markets as fairly balancing the interests of customers and shareholders. Pennsylvania regulation is ranked as a 2 on a scale of 1 to 5 by Lehman Brothers, with 1 being most supportive and 5 being least supportive to investors. PPL Electric St. 10, pp. 17-18. The perception of capital markets is important. If the perception of the quality of Pennsylvania regulation declines, it is likely that capital costs, both the cost of debt and equity, will increase, as evidenced by the fact that the S&P bond rating criteria include an evaluation of the supportiveness of regulation, from the perspective of investors. If investors perceive a change in the quality of regulation, the bond rating of PPL Electric, and other Pennsylvania utilities, may be adversely affected. When bond ratings are lowered, capital costs increase. PPL Electric St. 10, pp. 17-20.

PPL Electric's current bond ratings are A minus from S&P and Baa2 from Moody's. PPL Electric St. 9, p. 12. Furthermore, PPL Electric presently has a negative outlook from S&P. As stated by S&P:

"The negative outlook reflects the still weak credit metrics and the uncertainty surrounding the outcome of the rate case, filed with the PUC in March, 2004. Although the company expects new PUC rates to bolster its performance after 2004, if new rates do not result in improvement in credit ratios, the ratings on PPLEU [PPL Electric] will be lowered." PPL Electric St. 9-R, p. 11.

The Commission's goal should not be limited to providing PPL Electric with an opportunity to earn a return that will be sufficient only to avoid a downgrading of the Company's current A minus bond rating. Instead, the Commission should provide PPL

Electric with an opportunity to create a credit profile that will produce an upgrade to an A bond rating from S&P and the Company's Baa2 rating from Moody's. An A bond rating will lower the Company's capital costs in the future. An ROE allowance that will provide an opportunity to produce such a credit profile will provide access to the capital markets at a reasonable cost and demonstrate that the Commission is committed to ensuring that Pennsylvania public utilities have access to the capital that is necessary to maintain and improve the Commonwealth's infrastructure.

This Commission, in several recent decisions, has demonstrated its commitment to ensuring that well-run utilities have access to capital markets on reasonable terms. In its recent decisions in *Pa. P.U.C. v. Pennsylvania-American Water Co.*, R-00038304 (January 16, 2004) ("*Pa.-American*")^{1/} and *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, R-00038805, (August 5, 2004) ("*Aqua Pa.*"), the Commission concluded that an appropriate ROE was 10.6%. While much has been made by other parties in this proceeding of PPL Electric's allegedly reduced risk as an electric distribution company, it is widely agreed that the totality of investment risk is captured by a company's bond rating. PPL Electric St. 9, p. 12.^{2/} Furthermore, S&P ranks the business risk of companies on a scale of 1 to 10 with 1 being least risk. As shown below, PPL Electric is clearly riskier than Pennsylvania-American Water Co. ("*Pa.-American*") and Aqua Pennsylvania, Inc. ("*Aqua Pa.*") under these widely accepted standards.

1/ The Commission's decision in *Pa.-American* was affirmed by the Commonwealth Court on November 8, 2004, at No. 301 C.D. 2004, Opinion Not Reported.

2/ PPL Electric's bond rating today is lower than the A-2 from Moody's and the same as A minus from S&P at the time of its last rate case. Tr. 562-63.

| | S&P Business Profile | S&P Bond Rating |
|--------------|----------------------|-----------------|
| Pa.-American | 2 | A |
| Aqua Pa. | 2 | A+ |
| PPL Electric | 4 | A- |

(with negative outlook)

(PPL Electric St. 9-R, p. 24, PPL Electric Ex. PRM2)

In the face of the PPL Electric's greater risk, rising interest rates,^{3/} and the Commission's recent decisions in *Pa- American* and *Aqua Pa.* that the cost of equity is 10.6%, the ALJ's recommended ROE of 10.25% is clearly inadequate. Moreover, her recommendation is near the lower end of the range of ROE determinations by all commissions in 2003:

| 2003 ROE Determinations | Number | Percent |
|-------------------------|--------|---------|
| Less than 10% | 5 | 12% |
| 10% to 10.9% | 13 | 30% |
| 11% to 11.9% | 19 | 44% |
| Higher than 12% | 6 | 14% |

PUR Utility Regulatory News (December 26, 2003); PPL Electric St. 9-R, p. 6.

The average ROE allowance in 2003, a period in which projected interest rates were substantially lower than at the close of the record in this case, was 11.02%. PPL Electric St. 9-R, pp. 6, 23.

The ALJ's 10.25% recommendation is also at the low end of the range expected by the investment community. Ms. Julie Cannell, a former utility investment analyst,

^{3/} It also is noted that the water companies are permitted to charge a Distribution System Improvement Charge ("DSIC") to recover return and depreciation on non-revenue producing plant additions between rate cases. PPL Electric proposed a DSIC in this proceeding, which the ALJ rejected. The ALJ did not reflect her proposed rejection of the DSIC in the recommended equity allowance even though the proposed rejection of the DSIC is yet another indication of greater risks compared to the water companies.

The Federal Reserve increased interest rates on June 30, 2004, (PPL Electric St. 9-R, p. 4), on August 10, 2004, on September 21, 2004, and again on November 10, 2004. Greg Ip, *Fed Raises Rates, Seeing Slowdown as Temporary*, Wall Street Journal, August 11, 2004, at A1; Ruth Simon, *Fed Moves Rekindle Interest in Saving*, Wall Street Journal, September 22, 2004, D1; *What's News*, Wall Street Journal, November 11, 2004, at A1.

explained that capital markets expect ROE allowances in the range of 10% to 12% in 2004 with allowances at the higher end of the range later in the year to reflect expected higher interest rates in 2005 and recent increases in short term rates by the Federal Reserve. PPL Electric St. 10, p. 15; PPL Electric St. 10-R, pp. 3-4.

It is important that the Commission provide consistent signals to the capital markets. An ROE allowance that is less than that afforded Pennsylvania water utilities when the market views PPL Electric as having greater risk than those companies is not a consistent signal. Although the Commission should not, and cannot, make its determinations solely to satisfy the expectations of capital markets, it is the capital markets that determine the cost of capital. As illustrated above, the ALJ's recommendation is clearly below the Commission's own recent ROE determinations and the norms experienced and expected by the capital markets. This is not the path that Pennsylvania has followed in the past nor the path it should follow in the future.

b. The ALJ Erred In Determining That The Cost Of Equity Is 10.25 Percent.

PPL Electric supports the ALJ's recommendation that an **unadjusted DCF only** analysis indicates a cost of equity of 10.25%. The problem is that the ALJ erred in stopping her analysis there. The ALJ's analysis is incomplete, for the following reasons:

- The Commission has correctly concluded that an unadjusted DCF analysis understates the cost of equity under current market conditions (*Aqua Pa.*, p. 63);
- The Commission has correctly concluded that the initial DCF analysis must be adjusted (*Pa.-American*, pp. 83-85) and/or weight must be given to the risk premium and CAPM analyses in arriving at the cost of equity (*Aqua Pa.*, p. 63); and

- The ALJ apparently gave no weight to PPL Electric's superior customer service, customer satisfaction and the fact that PPL Electric has provided the highest level of service to its customers without a net increase in total rates in 18 years (PPL Electric St. 1, pp. 3, 6-7).

As explained by PPL Electric's President, John F. Sipics, the Company's commitment to the highest quality of service has never diminished. This commitment is evidenced by excellent results, including the following:

- PPL Electric has met or exceeded reliability standards as measured by the Customer Average Interruption Index, the System Average Interruption Index and System Average Interruption Frequency Index in all but one year of the rate cap period;
- PPL Electric focuses on the few instances where the indices decline and implements appropriate initiatives to improve performance;
- PPL Electric has received numerous JD Power and Associates awards for customer satisfaction and was ranked highest in the nation for combined electric and gas utilities in 2001, 2002 and 2003; and
- Eighty eight percent of customers rank PPL Electric as an above average service provider and customers rank PPL Electric 8.3 on a scale of 1 to 10 on overall satisfaction with 10 being "outstanding." (PPL Electric St. 1, pp. 5-6)

It is not surprising that PPL Electric is highly regarded by its customers. The Company has continued its commitment to service during the rate cap period despite a return on equity of less 2% in 2003. PPL Electric St. 1, p. 3.

As summarized later in these Exceptions and explained more completely in briefs to the ALJ, an adjusted DCF analysis indicates an equity rate of 10.69%, the appropriately calculated CAPM results range from 10.71% to 11.00% for the Electric Group, the Risk Premium results range from 10.44% to 11.75%, and the comparable earnings approach indicates a cost rate of 14.25%. All of these results exceed the ALJ's recommendation of 10.25%. As a group, they fully support PPL Electric's claimed equity cost rate of 11.5%. This cost rate would be consistent with the 10.6% cost of

equity in *Pa.-American* and *Aqua Pa.*, given PPL Electric's riskier profile and PPL Electric's superior customer service, high levels of customer satisfaction and extraordinary management performance as evidenced by maintaining these levels of service without significant rate increases over the last 18 years.

2. Capital Structure

a. The ALJ Erred In Failing To Include 2004 Growth In Retained Earnings In The Capital Structure.

PPL Electric's proposed capital structure reflects the estimated balances of long-term debt, preferred stock and common equity, including retained earnings, at December 31, 2004, the end of the future test year. These balances include projected retirements of long-term debt in 2004, and a projection that PPL Electric's retained earnings will grow by \$15 million in 2004. PPL Electric St. 9, p. 19; PPL Electric Ex. PRM1, p. 1.

The ALJ accepted OCA's contention that the projected growth in retained earnings in 2004 should be excluded from the equity balance in the capital structure. Although OCA based its contention on the argument that PPL Electric would not actually have growth in retained earnings in 2004, the ALJ concluded as follows:

"The question for the Commission is not only whether there will be the amount of retained earnings at the end of 2004 that PPLEU claims, but whether this amount of year-end retained earnings is likely to continue over the lifetime of these rates. Although PPLEU does project large construction budgets over the next five years, it is not at all clear that the Company will be able to build up or retain a high level of retained earnings, or indeed, whether it will want to do so. After balancing PPLEU's claim and OCA's analysis, the ALJ recommends adoption of the capital structure proposed by OCA, minus PPLEU's proposed amount for retained earnings." RD, p. 100.

As to the first issue, the record is clear. PPL Electric's retained earnings grew by \$34 million in the first half of 2004, more than enough to justify its projection that its retained earnings would grow by \$15 million for the entire year. PPL Electric St. 9-R,

pp. 7-8; PPL IB, p. 74. The fact that PPL Electric did not have significant growth in retained earnings in 2003 is not relevant because PPL Electric, as recognized by the ALJ, experienced extraordinary severance costs in 2003. RD, p. 100.^{4/}

The second point raised by the ALJ appears to misunderstand PPL Electric's claim. The ALJ suggests that PPL Electric's 2004 growth in retained earnings should not be reflected in the earnings balance at the end of the future test year, because PPL Electric may "... not be able to build up or retain a high level of retained earnings ..." in the future. This contention was not raised by any party. There is no evidence to suggest that PPL Electric's retained earnings will decline after 2004. Such a contention runs counter to the Company's objective of strengthening its common equity to sustain, and hopefully improve its bond ratings. To the contrary, PPL Electric's commitment to grow retained earnings, combined with the additional revenue that will result from this case, fully support the Company's claim. There is simply no basis to conclude that retained earnings will decline in the future. Furthermore, failing to reflect the balance of retained earnings at the end of the future test year on the assumption that retained earnings may decline in 2005 also mismatches the capital structure with the test year-end balances of plant in contradiction to the test year matching principle.

The ALJ improperly rejected PPL Electric's projection that its equity balance will grow by a modest \$15 million in 2004 due to growth in retained earnings.

4/ OCA's witness also contended that it was not appropriate to include 2004 growth in retained earnings in the capital structure because that would increase the rate allowance. OCA St. 3-S, p. 12. If the Commission were to adopt such an approach, utilities would be discouraged from retaining earnings and investing such earnings in plant to serve customers.

3. Cost Of Equity

a. The ALJ Erred In Determining The Cost Of Equity Based Solely Upon An Unadjusted DCF Analysis.

The ALJ based her recommendation to set the cost of equity at 10.25% upon the unadjusted DCF analysis of 10.25% presented by DOD Witness Kincel. It should be noted the PPL Electric witness Moul also calculated an unadjusted DCF cost rate of 10.25% for the Electric Group, which when adjusted for financial risk increases to 10.69%. PPL Electric St. 9, p. 37. The ALJ recognizes that the Commission has concluded that a financial risk adjustment is necessary to correct the understatement of the cost of equity when barometer group market prices exceed book values, quoting *Aqua Pa.*, p. 3; *Pa.-American*, pp. 83-85. RD, pp. 120-121. Nevertheless, the ALJ rejected the financial risk adjustment based upon DOD Witness Kincel's testimony that this adjustment to the DCF analysis was not appropriate and the ALJ's conclusion that Mr. Kincel had accounted for the deficiency in the DCF by adopting the high end of his growth rate range (5.5%). RD, p. 121.

The ALJ fails to note, however, that DOD Witness Kincel specifically concluded that the DCF analysis understates the cost of equity when market prices substantially exceed book values "... because the constant growth model tends to be less reliable . . ." under these circumstances. DOD St. 2, p. 14. Although Mr. Kincel attempted to partially adjust for this deficiency by adopting the high end of his growth rate range for use in the DCF analysis, he also concluded that other cost rate methodologies must be given weight, particularly the CAPM analysis. Based upon his CAPM result of 11.0%, he adopted a cost rate range of 10.25% to 11.0% and a recommendation of 10.75%. DOD St. 2, p. 16.

The ALJ is incorrect in concluding that Mr. Kincel has adequately accounted for

understatement of the cost of equity in the DCF by adopting the high end of his growth rate range. Use of the high end of the growth rate range is justified by the fact that electric distribution companies are relatively new entities and there have been few rate allowances for such companies due to T&D rate caps. Investors and analysts are uncertain of future earnings and likely reflect such uncertainty by making conservative estimates of future growth rates, thereby depressing DCF results.

PPL Electric submits that Mr. Kincel's analysis is consistent with the Commission's recent decisions in *Aqua Pa.* and *Pa.-American*, even though it does not specifically adopt a financial risk adjustment. Mr. Kincel's analysis is consistent with these cases because he gave weight to results of other cost of equity models and did not rely solely on an unadjusted DCF result. The primary point of these decisions is that sole reliance on an unadjusted DCF analysis understates the cost of equity. Either the DCF result must be adjusted for financial risk or other methodologies must be employed. Although the Commission concluded in *Aqua Pa.* that a financial risk adjustment to the DCF is required, the Commission also stated as follows:

"The ALJ recommended a 10.0% cost of equity, relying too heavily on the DCF methodology. However, the ALJ failed to sufficiently consider the other standard financial models, including Comparable Earnings, the Risk Premium Model, and the CAPM, as checks upon the reasonableness of the DCF results. *See generally, PA P.U.C. v. Philadelphia Suburban Water Company*, 219 PUR 4th 272 (2002)." *Aqua Pa.*, 62.

The RD relied solely on an unadjusted DCF result, made no financial risk adjustment to the DCF analysis and failed to consider any CAPM or Risk Premium analyses. The RD therefore is inconsistent with the Commission's conclusions in *Aqua Pa.* and *Pa.-American* that the sole reliance on an unadjusted DCF analysis understates the cost of equity.

b. The Commission Should Either Adjust The DCF Analysis Or Give Weight To Other Methodologies.

PPL Electric's Witness, Mr. Moul, calculated the adjustment to the DCF analysis in this proceeding in the same manner as he did in *Pa.-American* and *Aqua Pa.* and concluded that his unadjusted DCF result of 10.25% should be increased by .44% to 10.69%.^{5/} PPL Electric St. 9, p. 37.

Mr. Moul also calculated a CAPM cost rate of 10.71% for the Electric Group and a risk premium cost rate of 11.75%. Based upon all the methods and PPL Electric's extraordinary service, Mr. Moul recommended a cost rate of 11.5%. PPL Electric St. 9, pp. 43, 47, 51. Accordingly, an equity cost rate of 11.5% is consistent with the Commission's decisions in *Aqua Pa.* and *Pa.-American* and fully supported by the record in this case. Therefore, the Commission should adopt an equity cost rate of 11.5%.

B. PPL ELECTRIC'S PROPOSED DISTRIBUTION SYSTEM IMPROVEMENT CHARGE SHOULD BE APPROVED.

The ALJ concluded that PPL Electric's proposed Distribution System Improvement Charge ("DSIC") should not be implemented as proposed. Although the ALJ expressed certain concerns about some features of PPL Electric's proposed DSIC, she also concluded that some form of DSIC should be approved following legislative input. RD, p. 47. As explained below, no legislative input is necessary, and the ALJ's

^{5/} The ALJ references certain criticisms of Mr. Moul's leverage or financial risk adjustment at page 116 of the RD, but does not adopt these criticisms as a basis for rejecting the adjustment. RD, p. 122. OCA argues that the leverage adjustment is overstated because PPLEU has less leverage than the barometer group. There are two errors in this argument. First, the DCF cost of equity is determined from the barometer group and it is the leverage difference between book and market capitalization of the barometer group that results in the understatement of the cost of equity. Second, PPLEU must have less leverage and more equity because it has a more risky business position than the barometer group. PPL Electric St. 9-R, p. 18. OCA also argues that Mr. Moul did not consider short-term debt. However, Mr. Moul explained that inclusion of short-term debt in both the market and book capitalizations would produce no different result. PPL Electric St. 9-R, p. 18; PPL Electric RB, pp. 36-37.

proposed design changes are inappropriate. PPL Electric also will address several concerns mentioned by the ALJ even though those concerns did not dissuade the ALJ from concluding that a DISC would be in the public interest.

Before addressing the specific issues, however, PPL Electric emphasizes that the DSIC is of great importance. Over the five-year period from 2004 through 2008, PPL Electric plans to invest a total of \$987 million in new and replacement plant in order to continue to provide safe, adequate and reliable service. It is imperative that the Commission approve a rate mechanism under which at least a portion of such substantial capital expenditures can be recognized in rates promptly and in a manner that is fair to both PPL Electric and ratepayers in order to reduce the adverse economic impact of such substantial expenditures on PPL Electric's financial condition. PPL Electric believes that the DSIC, which is patterned after the DSIC which the Commission approved for water companies and the CSIC which the Commission approved for sewer companies, provides such a mechanism.

1. Legal Authority For The DSIC

The ALJ expressed uncertainty with regard to the authority of the Commission to approve a DSIC for PPL Electric. RD, pp. 42-43. PPL Electric has fully addressed these concerns in its Initial Brief, 112-21, and Reply Brief, 56-62. More importantly, however, the Commission clearly does not share the ALJ's concerns. Late last year, the Commission approved a Collection System Improvement Charge ("CSIC") for Pennsylvania-American Company. In *Pa. P.U.C. v. Pennsylvania-American Water Co.*, Docket No. R-00027982 (Nov. 7, 2003) ("*CSIC Order*"),^{6/} the Commission rejected the

^{6/} The OCA has appealed the *CSIC Order* to the Commonwealth Court of Pennsylvania. The appeal is pending at No. 2497 C.D. 2003.

same arguments that caused the ALJ's concerns and approved a CSIC for Pennsylvania-American Water Company without additional legislative authority. The Commission properly concluded that it has authority under Section 1307(a) of the Public Utility Code, 66 Pa.C.S. § 1307(a), to authorize the CSIC. *CSIC Order*, 11-16.

Section 1307(a) of the Public Utility Code, 66 Pa.C.S. § 1307(a), authorizes the Commission to approve PPL Electric's proposed DSIC. It states:

General rule. – *Any public utility, except common carriers and those natural gas distributors with gross intrastate annual operating revenues in excess of \$40,000,000 with respect to the gas cost of such natural gas distributors, may establish a sliding scale of rates or other method for the automatic adjustment of the rates of the public utility as shall provide a just and reasonable return on the rate base of such public utility, to be determined upon such equitable or reasonable basis as shall provide such fair return. A tariff showing the scale of rates under such arrangement shall first be filed with the commission, and such tariff, and each rate set out therein, approved by it. The commission may revoke its approval at any time and fix other rates for any such public utility if, after notice and hearing, the commission finds the existing rates unjust or unreasonable. (Emphasis added.)*

Section 1307(a) authorizes adjustment mechanisms subject to the requirement that any such mechanism must “provide a just and reasonable return on the rate base . . . to be determined upon such equitable or reasonable basis as shall provide such fair return.” Nothing in Section 1307(a) limits the kinds of costs that may be recovered thereunder or withholds from the Commission authority to fashion a mechanism to recover the fixed costs of utility plant. In fact, the operative language specifically references both “return” and “rate base,” as PPL Electric has proposed to reflect in the DSIC.

Section 1307 leaves to the Commission the task of designing rate adjustment mechanisms that satisfy the “just and reasonable” and “fair return” criteria. *National Fuel Gas Distribution Corp. v. Pa. P.U.C.*, 81 Pa. Cmwlth. 148, 167, 473 A.2d 1109,

1118-19 (1984).^{7/} The “just and reasonable” and “fair return” criteria articulated in Section 1307 are consistent with the same concepts that apply under other provisions of Chapter 13 of the Public Utility Code. In like fashion, the Commission’s authority to design rate adjustment mechanisms under Section 1307(a) that comport with the “just and reasonable” and “fair return” standards is as broad as its authority to set other utility rates. Contentions that the Commission lacks statutory authority to approve PPL Electric’s proposed DSIC are without basis.

Certain parties argue that Section 1307(g) of the Public Utility Code, 66 Pa.C.S. § 1307(g), limits the Commission’s authority under Section 1307(a). Such arguments are erroneous. Section 1307(g) provides:

“Recovery of costs related to distribution system improvement projects to enhance water quality, fire protection reliability and long-term system viability.— Water utilities may file tariffs establishing a sliding scale of rates or other method for the automatic adjustment of the rates of the water utility as shall provide for recovery of the fixed costs (depreciation and pretax return) of certain distribution system improvement projects, as approved by the commission, that are completed and placed in service between base rate proceedings. The commission, by regulation or order, shall prescribe the specific procedures to be followed in establishing the sliding scale of rates or other automatic adjustment method.”

Opposing parties erroneously contend that Section 1307(g) demonstrates a legislative intent that the fixed costs of plant in service may not be recovered under Section 1307 by any utility group other than water utilities. OTS St. 5, pp. 8-9. OTS interprets Section 1307(g) in conjunction with Section 1924 of the Statutory Construction Act, 1 Pa.C.S.

^{7/} There, the Commonwealth Court held that: (1) the “primary regulatory purpose” of Section 1307(a) is embodied in the “fair return” requirement; and (2) by this means, the General Assembly granted the Commission authority and discretion to design “detailed procedures by which a utility shall translate a mandatory rate adjustment mechanism prescribed by the Commission into particular customer charges.”

§1924, which states that: “Exceptions expressed in a statute shall be construed to exclude all others.” That argument fails for three principal reasons.

First, nothing in Section 1307(g) identifies it as an “exception” to anything.

Second, when the General Assembly has created “exceptions” that limit the otherwise broad and inclusive authority of the Commission to establish rate adjustment mechanisms under Section 1307(a), it has done so explicitly by placing the “exceptions” in Section 1307(a). When the General Assembly enacted Section 1307(f) to impose separate, more rigorous, procedures for the recovery of gas costs by large gas utilities, it coupled that addition with amendments to Section 1307(a) specifically “excepting” the recovery of gas costs by such utilities from that section.

Third, the existence of subsections within Section 1307 that specifically address particular utility groups or particular categories of costs does not imply that other utility groups or costs are outside the permitted scope of cost recovery under Section 1307(a). Indeed, if that approach to statutory construction were adopted, then “fuel” expenses for electric and gas utilities – for which specific provisions exist in Sections 1307(c) and (d) – would be the only costs cognizable under Section 1307(a). The Commonwealth Court, however, has rejected that argument, finding that the costs “specifically allowed” under Section 1307 did not preclude the recovery of other costs:

“[T]he General Assembly did not limit the allowance of automatic adjustment to only fuel costs and taxes which are generally beyond the control of the utility. Instead, the General Assembly *specifically allowed* the recovery of fuel costs *and also allowed the PUC or the utilities themselves to initiate the automatic adjustment of costs within specific procedures.*” (Emphasis added.)

Pennsylvania Industrial Energy Coalition v. Pa. P.U.C., 653 A.2d 1336, 1349 (Pa. Cmwlth. 1995).

The Commission approved the first DSIC in Pennsylvania in *Petition of Pennsylvania-American Water Co.*, 86 Pa. PUC 415 (1996) (“*DSIC Order*”). There, the Commission explained at length that Section 1307(a) provides ample authority for a DSIC. The Commission’s analysis of its powers under Section 1307(a) was not restricted to any particular utility group. After the *DSIC Order* was entered, the OCA appealed on the ground, among others, that the Commission lacked authority for a DSIC. While that appeal was pending, the General Assembly enacted, and the Governor signed into law, Section 1307(g), and OCA withdrew its appeal.

Nothing in Section 1307(g) suggests that the Legislature intended to overrule the *DSIC Order* or alter the Commission’s conclusions stated therein regarding its powers under Section 1307(a). By enacting Section 1307(g), the Legislature did not give the Commission a power it did not already possess. Instead, it reaffirmed the Commission’s pre-existing authority and emphasized the importance of exercising that power to achieve the stated goal of “distribution system improvement . . . designed to enhance water quality, fire protection reliability and long-term system viability.” The fact that Section 1307(g) mentions only water utilities is not surprising because only the application of Section 1307 to water utilities was at issue in the *DSIC Order*.

2. Legislative Input

In concluding that further legislative input would be appropriate prior to implementing a DISC for PPL Electric, the ALJ erred by relying upon the testimony of the Northeast Delegation on the legislative intent of Section 1307(g). RD, pp. 37-38. In evaluating this testimony, it should be recognized that two of the sponsors of the testimony were not in the General Assembly when Section 1307(g) of the Public Utility

Code was enacted in 1996. Act of December 18, 1996, P.L. 1081, No. 156, § 1.^{8/}

Further, the remaining legislators in the Northeast Delegation who were members of the House when Section 1307(g) was enacted all voted against it. *Legislative Journal – House* November 26, 1996, 2604.

Moreover, after-the-fact comments by legislators about legislative intent are given no weight by courts attempting to determine legislative intent. Subsequent observations by those involved in the legislation's creation are not to be considered in interpreting legislation. N. Singer, 2A Statutes and Statutory Construction, § 48:04, pp. 430-31, (2000 Rev.). Similarly, testimony from individual legislators about the intent of the General Assembly should be disregarded. *Id.*, § 48:16, pp. 478-79 (2000 Rev.). Post enactment statements of legislators on legislative intent are to be disregarded. *Id.*, § 48:20, pp. 488-89.

The ALJ's suggestion that the Commission should await further legislative input prior to implementation of a DSIC for PPL Electric also is inappropriate. If the Commission wishes further guidance from the General Assembly on whether a DSIC is appropriate for PPL Electric, the Commission should follow the same procedures that it employed with regard to DSICs for water companies. In that instance, the Commission approved a DSIC for water companies, and shortly thereafter, the General Assembly adopted Section 1307(g) of the Public Utility Code, thereby removing any argument concerning the Commission's authority to approve DSICs for water companies. If the Commission were to approve a DSIC for PPL Electric, there is little reason to doubt that,

^{8/} Representative Todd Eachus became a member of the House in 1997 and Representative Jim Wnsacz became a member of the House in 2000 (See, www.legis.state.pa.us/cfdocs/legis/home/member.)

if the General Assembly felt strongly that such a DSIC were either appropriate or inappropriate, it would enact legislation to address these issues.

3. Design Changes

The ALJ recommended two different design changes for PPL Electric's proposed DSIC. She suggested that the period between the annual filing of the DSIC and the effective date be extended beyond the month proposed by PPL Electric and that "mini-reviews" of the DSIC take place annually or biennially. In addition, the ALJ recommended a "sunset" provision under which the DSIC would be eliminated on December 31, 2009, when PPL Electric's generation rate cap expires. RD, pp. 43-47.

PPL Electric suggests that there is no need to extend the review period for revisions to the DSIC. The Company has proposed notice to the Commission, the OTS, OCA and OSBA one month prior to annual rate changes. In contrast, the DSIC for water utilities, which has been operating successfully for more than eight years, calls for quarterly filings with the Commission to become effective on ten days' notice. PPL Electric believes that one month notice is sufficient given the fact that the DSICs for water utilities are modified upon ten days' notice.

PPL Electric also believes that the ALJ's proposed sunset date for the DSIC is unreasonable. In support of her proposal for a sunset, the ALJ stated: "The need for repairing and replacing aging plant from the 60's, 70's and 80's should come to an end." Apparently, the ALJ believes that PPL Electric will replace aging plant installed over a thirty-year period within a five-year period. Such expectations are unrealistic. Further, the replacement of aging infrastructure is an ongoing process. In illustrating the problems by reference to plant additions from 1960 through 1989, PPL Electric was not suggesting that older plant would not have to be replaced or that newer plant will have to

be replaced at a later time. There is no basis for the ALJ's proposed sunset provision. Further, the Commission has not imposed a sunset date on DSICs for water companies or CISCs for sewer companies. None should be imposed here.

4. The ALJ's Other Concerns

a. Adequacy Of Facilities And Service

The ALJ concluded that PPL Electric had not demonstrated a need to repair and replace electric facilities that is equivalent to the need facing water and wastewater utilities in the *DSIC Order* and the *CSIC Order*. The ALJ stated:

“PPLEU [PPL Electric] is deservedly proud of its service and safety records and came nowhere near averring that it is approaching serious reliability problems or that its facilities are so aged that they are near collapse and thus are a threat to the public, its customers or its workers.” RD, p. 36.

The ALJ's statements are factually correct but provide no basis for denying PPL Electric's proposed DSIC.

Despite the adequacy of PPL Electric's system and facilities, PPL Electric will have to make substantial expenditures in the forthcoming years to maintain quality of its service and facilities at current levels. Further, as a matter of public policy, approval of the DSIC by the Commission will support PPL Electric's efforts to undertake appropriate measures to maintain a high level of service and safety. PPL Electric also notes that, despite the ALJ's above-quoted observations, she did ultimately recommend approval of a DSIC, albeit with some modifications.

b. Lack Of Dire Circumstances

The ALJ raised the issue of whether a utility is required to demonstrate that it is in dire circumstances in order to qualify for a DSIC. RD, p. 37. The ALJ concluded that PPL Electric had not demonstrated dire circumstances, but it had demonstrated that it

would experience regulatory lag in recognizing construction expenditures in its rates. Obviously, the ALJ concluded that dire circumstances are not required to qualify for a DSIC because she recommended approval of a DSIC for PPL Electric, albeit with certain modifications, following legislative input.

PPL Electric notes that the Commission has not required other utilities to demonstrate that they are in dire circumstances to qualify for a DSIC or CSIC. Pa.-American Water Co. was not required to show that it was in dire circumstances in order to gain approval of its CSIC. The Commission stated:

“On this basis, we conclude that the adverse financial impact that the Company [Pa.-American] would experience, were it to be forced to substantially increase wastewater investment without a CSIC, is a matter of concern. It is because the Company is in sound financial condition that it has access to capital and reasonable rates and, therefore, is in a position to help rebuild Pennsylvania’s aging infrastructure. It would not be in the public’s long-term interest to speed up the re-construction of wastewater infrastructure if the consequences of doing so are to diminish the Company’s financial capability, restrict its assets to capital or increase the cost of obtaining financing.” *CSIC Order*, p. 18.

Further, in the *DSIC Order* the Commission approved a generic form of DSIC for water companies. No water company has been required to demonstrate that it is in dire circumstances to qualify obtain a DSIC.

C. CAPITAL STOCK TAX SHOULD BE CALCULATED FOR RATEMAKING PURPOSES USING DATA FOR THE FUTURE TEST YEAR AS ADJUSTED FOR RATEMAKING PURPOSES AT PROPOSED RATES AND NOT BASED UPON A PROJECTION OF DATA FOR THE YEAR FOLLOWING THE FUTURE TEST YEAR.

The ALJ adopted the adjustments to Capital Stock Tax (“CST”) proposed by OTS. RD, pp. 89-94. The CST is calculated based upon, *inter alia*, a corporation’s average annual income over a five-year period. In its calculation, PPL Electric used

income for the five years commencing on January 1, 2000, and ending December 31, 2004, the end of the future test year in this proceeding.

The OTS proposed three different adjustments. First, OTS proposed to eliminate data for the year 2000 from the calculation because a portion of PPL Electric's income in that year related to operations of electric generation facilities which have been divested. PPL Electric does not except to the adoption by the ALJ of this OTS adjustment.

Second, the OTS proposed to calculate the CST by using the rate of 5.99 mills, which is scheduled to become effective on January 1, 2005, instead of the presently-effective rate of 6.99 mills. PPL Electric does not except to the ALJ's recommendation that this adjustment be accepted. Any difference between the CST rate that is scheduled to become effective on January 1, 2005, and the CST rate that actually becomes effective on January 1, 2005 can be addressed through the State Tax Adjustment Surcharge.

Third, the OTS proposed to include in the calculation of CST projected income for the year after rates established in this proceeding become effective, the twelve months ending December 31, 2005, the year **after** the future test year in this proceeding. PPL Electric does object to the ALJ's adoption of OTS' third adjustment to the calculation of CST. Although the resulting amount of CST is not unreasonable, the calculation is procedurally improper and unprecedented because it would constitute a major abandonment of test year concepts that the Commission has applied for many years.

The OTS' proposal to incorporate into the CST calculation projected income for the year after the future test year was, apparently, an attempt both to exclude earnings from 2000 and to give recognition to the statutory formula which calls for an averaging of income over five years. Such a procedure, however, is improper. It creates a

“disconnect” between the CST calculation and the remainder of the rate case, which will be determined based upon a future test year ending December 31, 2004, as adjusted for ratemaking purposes. No other element of PPL Electric’s revenue requirement is calculated based upon data for 2005.

As PPL Electric witness Joseph M. Kleha explained:

“It is obviously inappropriate to include the incremental Capital Stock Tax liability caused by the proposed rate increase as a part of the determination of the Company’s tax liability under present rates.

“In addition, contrary to Mr. Weakley’s assertion that the amount of the rate increase granted by the Commission would be an increase to book net income in the current year (2004), any increase granted by the Commission will become effective on January 1, 2005 and will be reflected in PPL Electric’s net income for 2005 tax year. Moreover, if the Commission were to grant PPL Electric the full amount of its proposed rate increase, the incremental Capital Stock Tax liability using Revenue’s calculation would be \$660,000, as shown on Exhibit JMK-5, not one-tenth of this amount, as Mr. Weakley suggests.

“The more appropriate approach, and the one which PPL Electric has used, without objection in all prior rate proceedings, is to first present its tax liability, including Capital Stock Tax liability, at present rates, and then ‘gross-up’ tax expense to reflect the effectively proposed rate increase. Mr. Weakley’s attempt to accomplish both steps in one calculation is confusing, and in this instance, erroneous. It is also inconsistent with PPL Electric’s and Mr. Weakley’s approach for all other taxes.” PPL Electric St. 5-R, pp. 16-17. (Emphasis in original.)

PPL Electric respectfully requests that the Commission not accept OTS’ erroneous proposal to calculate CST using projected income through 2005, the year **after** the future test year. This approach presents a hybrid calculation calculating tax at both present and proposed rates in one step. The correct calculation is shown at Exhibit JMK-5. As indicated previously, PPL Electric does not object to the **amount** of the CST as calculated by OTS. Instead, PPL Electric asks only that the Commission not accept OTS’

methodology which is both unprecedented and erroneous for the reasons explained above.

D. THE ALJ'S RECOMMENDATION TO ADOPT OTS' PROPOSED ADJUSTMENT TO SERVICE CORPORATION CHARGES IS INCORRECT AND DIRECTLY CONTRARY TO OTS' OWN TESTIMONY.

OTS proposed an adjustment to Service Corporation charges based upon its view that certain communications expenses were duplicated in rate case expense. OTS MB, p. 19. The ALJ accepted OTS' adjustment. RD, p. 77. The adjustment is based on a misinterpretation of PPL Electric's testimony. PPL Electric's testimony does not support such a conclusion. Further, the adjustment is contrary to the testimony of the OTS witness who affirmatively testified that there was no double count of these Service Corporation charges.

OTS' proposed adjustment was set forth initially in its case-in-chief in which OTS contended that the communications expense should be disallowed because it was a non-recurring expense. OTS St. 2, p. 25. Indeed, OTS specifically explained that the communications charge was **not** duplicative of rate case expense:

"Q. Is this rate case communications charge duplicative of the Company's rate case expense claim shown on PPL Ex. Future-1, 6-D?

A. No." OTS St. 2, p. 25.

The only basis in the evidentiary record for the adjustment was that the rate case communications expense was a non-recurring expense. OTS St. 2, p. 25.

PPL Electric witness Joseph R. Schadt responded to the OTS' contention concerning the non-recurring nature of the rate case communications expense as follows:

"Q. Do you agree that the expense is non-recurring?

“A. Yes, I agree the expense is non-recurring. However, even though it is a non-recurring cost, the Company should be allowed to collect the amount as a normal rate case expense. It appears that the confusion over this expense may result from the mechanics of the Company’s request to recover the rate case expense.

“In preparation of the rate case filing, PPL Electric anticipated \$2,000,000 in rate case expenses associated with the case. The \$2,000,000 of anticipated expenses include \$1,000,000 of budgeted expenses by PPL Services (including \$130,000 budgeted by External Affairs) and \$1,000,000 of expenses for legal fees, witnesses and other costs which were unbudgeted. The Company proposed amortizing the total anticipated rate case expense of \$2,000,000 over a two-year period, resulting in an annual amortization of \$1,000,000. Because this annual amortization of \$1,000,000 equals the budgeted rate case expenses of \$1,000,000 for PPL Services, no additional adjustment is appropriate to rate case expenses or PPL Services expenses.”

PPL Electric St. 2-R, pp. 9-10. This is PPL Electric’s only testimony on the rate case communications Service Corporation charges. Clearly, nothing in this testimony supports the notion that there was a duplication of these charges; indeed it is to the contrary. The OTS did not respond to this testimony.

Thus, the OTS’ claim, which was made for the first and only time in its Main Brief, that the rate case communications charges from the Service Corporation are duplicated in rate case expense, is unsupported by PPL Electric’s testimony and is exactly contrary to its own testimony.

E. PPL ELECTRIC SHOULD BE ALLOWED TO AMORTIZE EXPENSES RESULTING FROM THE AUTOMATED METER READING SYSTEM.

The ALJ recommended that PPL Electric’s proposed amortization of certain expenses arising from the installation of the automated meter reading (“AMR”) system be denied. One of the benefits of the AMR system is that it will save money because certain meter reader positions can be eliminated. The expenses at issue here are costs of enhanced early retirement pension benefits for meter readers whose positions have been

eliminated. The amount of the special termination benefit charge of \$8.8 million was actuarially calculated under the Statement of Financial Accounting Standards No. 88. The entire charge was recorded in the third quarter of 2003, when PPL Electric made final determinations of the related costs. PPL Electric proposed to amortize these enhanced early retirement expenses over 5 years. PPL Electric St. 2-R, p. 5.

Other parties had opposed the claim on various grounds including: (1) assertions that the amortization would violate the rate cap under the Competition Act, 66 Pa.C.S. § 2804(4), and the settlement of PPL Electric's restructuring proceeding⁹¹ and (2) assertions that the cost of the AMR exceeded its benefit. The ALJ properly rejected both of these arguments. RD, pp. 47-53, 59-60.

Nevertheless, the ALJ recommended disallowance of PPL Electric's amortization of the AMR expenses. The ALJ stated:

"The ALJ concludes that this is not a proper claim for amortization. This is not a large expense that has been paid or a large loss that requires devotion of a concentration of the Company's resources to overcome. This is in effect a virtual expense which was neither paid nor incurred by PPLEU. Amortization was not designed to cover this kind of expense.

"The ALJ recommends that the Company's claim for recovery of \$8.8 million of AMR displacement costs should be rejected. Since no payment was made, and none may ever have to be made, PPLEU should submit a claim in a rate case when and if that payment is required. . . ."
RD, p. 62.

The ALJ's recommendation is erroneous for several reasons. First, the ALJ erred in rejecting PPL Electric's claim because, in her opinion, the expense is not large. PPL

⁹¹ *Application of Pennsylvania Power & Light Company for Approval of its Restructuring Plan under Section 2806 of the Public Utility Code*, Docket No. R-000973954 (August 27, 1998). There, the Commission approved the "Joint Petition for Full Settlement of PP&L, Inc.'s Restructuring Plan and Related Court Proceedings" that had been filed in the same proceeding on August 12, 1998.

Electric respectfully contends that a one-time charge of \$8.8 million is large. Clearly, the amount of the expense is substantial, especially for a utility which earned less than 2 percent on equity in the historic test year and expects to earn less than that in the future test year. PPL Electric Ex. Future 1, Section A, p. 10.

The ALJ also misapprehends the basis for the amortization. Because the AMR system is capitalized, the capital costs of the AMR system will be recovered over many years through the useful life of the equipment. Similarly, economic benefits of reduced payroll resulting from the elimination of meter reading positions will benefit ratepayers over many years. One purpose of the amortization is to treat the special pension enhancement expense over a period of years in a manner more in line with the manner in which capital costs will be recovered and payroll expense reductions will be received by ratepayers. Indeed, the severances themselves will take place throughout 2003 and 2004 as the AMR deployment gradually eliminates the need for manual meter reading and related processes. PPL Electric St. 4, p. 18.

Nor are the ALJ's observations that the benefits were paid by the PPL Pension Trust Fund and that the expense was a non-cash accrual relevant. PPL Electric's pension expense for ratemaking purposes is, and has been for many years, based upon accrual accounting under SFAS No. 87. RD, pp. 63-66. *Pa. P.U.C. v. Pennsylvania Power & Light Co.*, 85 Pa. PUC 306, 329 (1995). It would be completely inconsistent for routine pension expenses to be determined for ratemaking purposes on an accrual basis while special early retirement pension enhancements charged to the same pension trust fund would be determined for ratemaking purposes on a cash basis.

F. THE ADJUSTMENTS TO THE AMORTIZATION OF STORM DAMAGE EXPENSES FROM HURRICANE ISABEL SHOULD BE REJECTED.

PPL Electric proposed to amortize expenses incurred to repair damage to its facilities, restore service and provide special services to customers as a result of Hurricane Isabel over five years. PPL Electric St. 4, pp. 39-45. OTS proposed to disallow regular wages that were recorded as storm damage expense and to amortize the remaining expenses over ten years. OTS St. 2, pp. 14-18. The ALJ accepted these adjustments. RD, pp. 54-58.

These recommendations should be rejected. Recovering costs over ten years is unreasonable where no return is allowed on the unamortized balance and is equivalent to a disallowance of a substantial portion of the expense. PPL Electric St. 4-R, p. 39. Further, the Commission should allow PPL Electric to recover regular wages that were recorded as storm damage expense because those wages represent a reasonable estimate of increases in other expenses that were caused by the disruption to PPL Electric's routine work schedules as a result of Hurricane Isabel. Simply stated, PPL Electric incurred increased costs such as overtime and outside services to make up for the delays in completing routine work due to Hurricane Isabel storm damage restoration, and PPL Electric should be allowed to recover these costs. PPL Electric St. 4-R, p. 38.

G. THE COMMISSION SHOULD CLARIFY THAT PPL ELECTRIC IS NOT REQUIRED TO OFFER UNMETERED TRAFFIC LIGHTING SERVICE OR PROVIDE REBATES TO MUNICIPALITIES FOR NEW SIGNAL LIGHTS.

Under PPL Electric's tariff, traffic lighting service is metered and provided under Rate Schedule GS-1. The PPL Public Lighting Users Group ("PLUG") proposed that PPL Electric's tariff be changed to offer unmetered service for traffic signals on the ground that such a change would support the use of energy-efficient light emitting diodes

(“LEDs”) in traffic signals instead of incandescent lamps. RD, pp. 158-59. PLUG also proposed that PPL Electric subsidize conversion of traffic signals to LEDs through rebates and that the Commission require PPL Electric to offer a pilot program (or, alternatively, to create a Commission “working group”) to develop an unmetered rate and rebates for traffic lights. *See* PLUG IB, pp.17-18; PLUG RB, pp. 8-9.

The ALJ acknowledged PPL Electric’s argument that existing metered service permits a municipality installing LEDs to realize any energy savings and did not direct PPL Electric to offer an unmetered traffic lighting rate or rebate program. RD, pp. 159, 161 (explaining that the Commission should reject all of PLUG’s proposals, including proposals relating to street lighting). However, the ALJ stated that she “favors PLUG’s intention to expand the use of LED traffic signals in this area as energy saving and efficient, and recommends that the Commission encourage PPL EU to cooperate with this effort.” RD, p. 159. Because the RD does not describe the nature of the cooperation favored by the ALJ, the Commission should clarify that PPL Electric is not required to offer any “pilot program” for an unmetered rate for traffic lighting or provide a rebate to government entities that choose to install LEDs in traffic lights.

As PPL Electric explained, PLUG’s proposal for an unmetered rate for traffic signals (which are owned by government entities, not PPL Electric) makes little sense. PPL Electric already has installed meters at traffic signals, and any municipality or other government entity that installs LEDs will immediately realize any savings arising from lower energy usage. RD, p. 159; PPL Electric IB, pp. 171-72; PPL Electric RB, pp. 100-02. PLUG also did not present any analysis of the costs or benefits of removing existing

meters and offering unmetered service. *See* PPL Electric RB, p. 102. Accordingly, the ALJ properly did not order PPL Electric to offer an unmetered rate.

Similarly, despite PLUG's contention that "simple math" demonstrates the benefits of a rebate program and why PPL Electric should become the first (and only) Pennsylvania utility to offer LED rebates, *see* PLUG IB pp. 17-18, PLUG failed to provide any of this "simple math" or justify why PPL Electric customers should subsidize municipalities' decisions to use LEDs through rebates. *See* PPL Electric RB, p. 102.

Apparently recognizing that its vague proposals were likely to be rejected, PLUG proposed that, if the Commission were to determine that such an unmetered rate was "premature," the Commission should direct PPL Electric to develop a "pilot program" for an unmetered rate and rebate or create a Commission "working group" to do so. PLUG IB, pp. 17-18; PLUG RB, pp. 8-9. In light of PLUG's failure to justify removal of existing meters that track actual savings from LEDs in favor of unmetered service or why PPL Electric customers should be providing rebates to municipalities, there is no basis to create a "pilot program" or "working group" to explore such ideas. However, PPL Electric is willing to cooperate with PLUG to examine the possibility of a program funded by the Sustainable Energy Fund to expand the use of LEDs in PPL Electric's service territory, as PLUG suggested. PLUG RB, pp. 8-9.

For these reasons, the Commission should clarify that PPL Electric is not required to "cooperate" by offering a "pilot program" for unmetered rate for traffic lighting or a rebate to subsidize government entities choosing to convert traffic lamps to LEDs, or to participate in any "working group" to develop such programs. The ALJ's RD regarding traffic lighting should otherwise be accepted.

H. PPL ELECTRIC'S FULL FUNDING FOR ONTRACK SHOULD BE APPROVED.

PPL Electric has sought a 25.6% increase in funding for OnTrack, PPL Electric's customer assistance program, raising total OnTrack funding from \$11.7 million to \$14.7 million to permit an enrollment of 15,000 to 17,000 customers. PPL Electric IB, p. 136. PPL Electric proposed that this \$3 million OnTrack funding increase be "ramped up" by increasing annual spending by \$1 million per year through 2007, with the difference in ratepayer funds collected and spent in 2005-07 escrowed to permit higher expenditures (\$15.7 million instead of \$14.7 million) in the years 2008-2010. PPL Electric RB, p. 136.

The OTS and OCA proposed that PPL Electric's OnTrack increase be limited to the average amount of funds PPL Electric has proposed to expend in the 2005-06 period (\$13.2 million annually) on the ground that PPL Electric may file another rate case in two years. The ALJ recommended that the Commission adopt this adjustment. RD, p. 72. However, the ALJ also recommended that if the Commission were to approve the full amount requested by PPL Electric, the escrowed funds should be kept in an interest-bearing account. *Id.*

The Commission should reject the ALJ's recommended funding level and approve PPL Electric's full \$14.7 million request for OnTrack funding. As PPL Electric explained, its funding request for OnTrack was based upon expected low-income customer needs and the Commission's review of PPL Electric's universal service programs in *Re: PPL's Universal Service and Energy Conservation Plan Submission in Compliance with 52 Pa. Code § 54.74*, Docket No. M-00031698 (June 12, 2003) ("*June 12 Order*"). In the June 12 Order, the Commission concluded that PPL Electric should have an OnTrack enrollment level of no less than 17,000 low-income customers. *June 12*

Order, p. 15.

PPL Electric's proposed funding is sufficient to enroll between 15,000 and 17,000 low-income customers. PPL Electric IB, pp. 137-38; PPL Electric RB, p. 68. However, PPL Electric proposed a "ramp-up" period appropriate for the community organizations involved in delivering OnTrack and to maintain administrative costs while increasing OnTrack enrollment by over 30%. PPL Electric RB, p. 68. The proposed funding reduction by OCA and OTS and adopted by the ALJ would freeze funding below the amount necessary to reach the enrollment level in the *June 12 Order*, and if PPL Electric did not return within two years with a new base rate case, many PPL Electric low-income customers would not receive benefits that the Commission and PPL Electric agree should be provided. *Id.* PPL Electric St. 7-R, p. 26 (explaining that the proposed adjustment may result in denial of OnTrack benefits to 1,500 low-income families).

In light of the ALJ's concern regarding the expenditure of funds collected from customers in the 2005-07 period, PPL Electric commits to using all OnTrack funds collected from customers to expand enrollment in OnTrack as quickly as possible without incurring excessive administrative costs. If any OnTrack funding remains unspent in the 2005-07 period, PPL Electric will escrow those funds in an interest-bearing account for expenditure in subsequent years, as the ALJ recommended.^{10/}

^{10/} PPL Electric does not except to the ALJ's related recommendation to adjust funding for PPL Electric's low-income Winter Relief Assistance Program ("WRAP") to 2003-04 levels. *See* RD, p. 71-72.

I. THE ALJ'S RECOMMENDED TRANSMISSION SERVICE CHARGE IS INCORRECT.

Following a substantial and thoughtful discussion of the issues, the ALJ recommended approval of PPL Electric's TSC as proposed:

"On balance, the ALJ recommends that the Commission allow the Company to put the reconcilable TSC as proposed in place." RD, p. 139.

No party contested PPL Electric's right to recover transmission service charges imposed on the Company by the PJM Interconnection, LLC under its Open Access Transmission Tariff, which is subject to the jurisdiction of the Federal Energy Regulatory Commission. Further, no party objected to the amount of transmission service charges to be recovered by PPL Electric. RD, p. 127. In these respects, PPL Electric's proposed TSC was uncontested.^{11/} Therefore, based upon the ALJ's recommendation that the TSC should be approved as proposed by PPL Electric, the TSC should be 0.564¢ or \$0.00564 per kWh. PPL Electric St. 4, p. 33; RD, p. 126.^{12/}

However, this rate has been stated erroneously at pages 124 and 134 of the RD. More importantly, without explanation, the TSC set forth in Ordering Paragraph No. 3 of the RD is incorrectly stated to be \$0.5439 per kWh. RD, p. 182. In the Errata, the recommended TSC was reduced to \$0.05439. The correct and uncontested TSC, however, is \$0.00564 or 0.564¢ per kWh, and this TSC should be reflected in the Commission's Final Order.

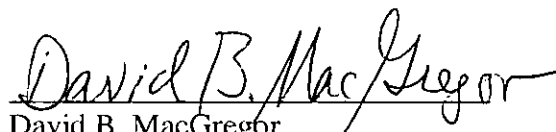
^{11/} Other parties, however, did raise issues concerning the allocation of transmission service charges among the rate classes and concerning reconciliation. RD, p. 127.

^{12/} The details of the calculation of the TSC of \$0.00564 are provided in PPL Electric Ex. DAK2.

IV. CONCLUSION

WHEREFORE, PPL Electric Utilities Corporation respectfully requests that the RD of Administrative Law Judge Allison K. Turner be modified in the manner explained above.

Respectfully submitted,



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Date: November 12, 2004

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served two copies of the foregoing "Exceptions of PPL Electric Utilities Corporation" upon the participant(s), listed below, in accordance with the requirements of §1.54 (relating to service by a participant):

VIA HAND DELIVERY ON NOVEMBER 12, 2004

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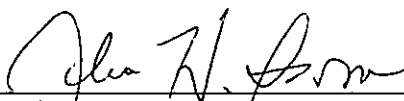
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CHARLES E. THOMAS
(1913 - 1998)

November 12, 2004

BY HAND DELIVERY

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DOCUMENT

In re: Docket No. R-00049255, et al.
Pa. P.U.C., et al. v. PPL Electric Utilities Corporation

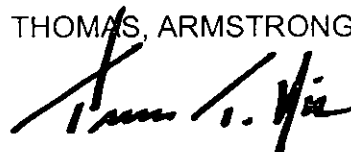
Dear Secretary McNulty:

Enclosed for filing on behalf of The Sustainable Energy Fund of Central Eastern Pennsylvania are an original and nine (9) copies of its Exceptions to the Recommended Decision of Administrative Law Judge Turner in the above referenced matter. Copies of the Exceptions are being served upon the persons and in the manner set forth on the certificate of service attached to them.

Very truly yours,

THOMAS, THOMAS, ARMSTRONG & NIESEN

By



Thomas T. Niesen

Encl.
cc: Certificate of Service (w/encl.)
Office of Special Assistants (w/encl. and disc)
Michael McFadden (w/encl.)

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Before the
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Administrative Law Judge Allison K. Turner Presiding

Pennsylvania Public Utility Commission : Docket No. R-00049255
v. :
PPL Electric Utilities Corporation :

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EXCEPTIONS OF
THE SUSTAINABLE ENERGY FUND OF
CENTRAL EASTERN PENNSYLVANIA
TO THE RECOMMENDED DECISION
OF ADMINISTRATIVE LAW JUDGE TURNER

DOCKETED
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AND NOW, comes The Sustainable Energy Fund of Central Eastern Pennsylvania ("SEF"), by its attorneys, and files the following Exceptions to the Recommended Decision of Administrative Law Judge Allison K. Turner, dated October 21, 2004, and transmitted to the parties by Secretarial Letter, dated October 22, 2004.

I. BACKGROUND

This proceeding concerns PPL Electric Utilities Corporation's ("PPLEU") Supplement No. 38 to Tariff Electric-Pa. P.U.C. No. 201 issued March 29, 2004 ("Supplement No. 38"). Supplement No. 38 proposes an increase in PPLEU's distribution rates of \$164 million.

SEF is a Pennsylvania non-profit corporation formed in accordance with the terms of the Joint Petition for Full Settlement of PPLEU's Restructuring Plan and Related Court Proceedings at Docket No. R-00973954. SEF St. No. 1 at 3 and PPL St. No. 7 at 21. SEF promotes the development and use of renewable energy and clean energy technologies, energy conservation and efficiency which promote clean energy.

PPL St. No. 7 at 22. Its Mission Statement is as follows (SEF St. No. 1 at 4 and PPL St. No. 7 at 22):

“Our mission is to promote, research, and invest in clean and renewable energy technologies, energy conservation, energy efficiency, and sustainable energy enterprises that provide opportunities and benefits for PPL ratepayers.”

SEF receives all of its funding through the application of the Sustainable Energy Fund Rider in PPLEU’s presently effective Tariff No. 201. The presently effective Rider is scheduled to expire on December 31, 2004. SEF St. No. 1 at 3-4.

PPLEU proposed in its Supplement No. 38, Third Revised Page No. 19K, to continue the Sustainable Energy Fund Rider at the current rate of 0.01 cents per KWH until not later than December 31, 2009. SEF St. No. 1 at 4. SEF intervened in this proceeding in support of continued funding for SEF.

In a Recommended Decision dated October 21, 2004, Judge Turner recommends that the “Commission adopt the Company’s SEF proposal” and “approve funding of SEF as part of PPLEU’s rates in the proceeding.” Rec. Dec. at 77 and 87. SEF takes no exception to the recommended adoption of PPLEU’s SEF funding proposal.

The Recommended Decision states further, however, that “consideration *could* be given to setting declining amounts, so that at the end of 5 years, or by December 31, 2009, funding will have ended.” Rec. Dec. at 87-88 (emphasis added). SEF submits the following Exception No. 1 in opposition to consideration of any declining amounts.¹

¹ At page 88 of the Recommended Decision after presenting the ALJ’s recommendation that begins at the bottom of the preceding page 87, the following language appears:

“PPLEU also recommends that :

To the extent the Commission has concerns regarding issues of program management and evaluation, project selection, or governance, the Commission can initiate a separate proceeding [or

(continued...)

II. EXCEPTIONS

1. **EXCEPTION NO. 1** - SEF excepts to that part of the discussion of SEF funding that concludes that "consideration could be given to setting declining amounts, so that at the end of 5 years, or by December 31, 2009, funding will have ended." Rec. Dec. at 87-88.

Judge Turner recommends that the Commission adopt PPLEU's SEF proposal and approve funding of SEF as part of PPLEU's rates in this proceeding. The Recommendation Decision further states, however, that consideration "could" be given to setting declining amounts, so that at the end of 5 years, or by December 31, 2009, funding will have ended.

PPLEU has proposed a constant funding rate of 0.01 cents per KWH for continued SEF funding until not later than December 31, 2009. SEF St. No. 1 at 4. The specific language of proposed Supplement No. 38 is as follows (PPL Exhibit OGK 1 at Third Revised Page No. 19K):

SUSTAINABLE ENERGY FUND

The Company will establish a sustainable energy fund which shall be funded from the Distribution Charges in each Rate Schedule at the rate of 0.01 cents per KWH (less applicable gross receipts tax) on all KWH delivered to all customers beginning on the effective date of this rider and ending not later than December 31, 2009.

¹(...continued)

establish a collaborative] to address those concerns instead of eliminating SEF funding in this proceeding.

PPLEU agrees with PLUG witness that the Commission should set standards for SEF. PPLEU St 7-R at 42; PPLEU MB at 156."

SEF does not interpret the above language to be part of Judge Turner's recommendation to the Commission. If it were part of her recommendation, it would have been phrased as such. It clearly was not. PPLEU's recommendations and positions were summarized in the preceding pages of the Recommended Decision and the above language at page 88 appears to be misplaced. The language would be more appropriate within the context of the material at the top of page 87, for example. SEF would disagree with the language if it were considered to be part of Judge Turner's recommendation. Program management and evaluation, project selection and governance were addressed on the record. The Commission should not be concerned with these matters. The position of PLUG witnesses were adequately responded to on the record. PLUG did not pursue its SEF related positions in its Main Brief.

No party proposed consideration of declining amounts and the evidence of record and the discussion of SEF and SEF funding presented in the Recommended Decision support continued funding at a constant rate. Environmental issues are important to customers and community leaders. With the continued, constant rate funding proposed in Supplement No. 38, SEF will continue to make significant contribution to building a *new sustainable energy environment, support public policy objectives regarding the environment, establish partnerships with government to address environmental needs and promote the development of renewable energy technologies.*

Currently, Pennsylvania is at a relative disadvantage in the development of a sustainable energy infrastructure as well as the associated job creation of an emerging technology sector. See SEF St. No. 1 at 9. As shown in the comparison of peer state funding presented in Attachment C to SEF Statement No. 1, a copy of which is attached to these Exceptions, Pennsylvania funding of SEF-type organizations is less than that which is occurring in each and every one of Pennsylvania's other Northeastern peer states.² If Pennsylvania were to consider and adopt declining levels of funding, it would stand in stark contrast to its neighbors. The benefits of SEF-type projects, in the form of clean air, less emissions, job creation and more, could easily flow away from Pennsylvania to neighboring states. Such a result would be inconsistent with the policies of the current administration in Pennsylvania and with the public interest as well.

In the electric restructuring proceedings, Pennsylvania took a first step to promote renewable energy technologies when the Commission approved settlements and implementing tariffs that provided for the funding of sustainable energy funds. The next step of continued, constant rate funding as proposed in Supplement No. 38 is

² Bordering states like New York and New Jersey, for example, are financing sustainable energy at rates at least 5 to 6 times greater than Pennsylvania. SEF St. No. 1 at 8.

appropriate and consistent with what has already occurred in the restructuring proceedings and what is continuing to occur in other states throughout the nation in regard to the development of a sustainable energy infrastructure. Continued, constant rate funding is an appropriate factor to reflect in the rates which will be set in this proceeding.

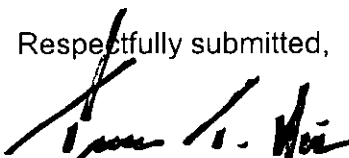
“Consideration” of a funding end date of December 31, 2009, is, moreover, unnecessary. Proposed Supplement No. 38 would continue the Sustainable Energy Fund Rider at the current rate of 0.01 cents per KWH until not later than December 31, 2009. Whether additional funding would be sought for SEF after December 31, 2009, would depend upon the condition of SEF at that time, the marketplace opportunities, the needs of society and so forth. *N.T. 784; PPL Exhibit OGK 1 at Third Revised Page No. 19K.*

SEF's Exception No. 1 should be granted.

III. CONCLUSION

Continued funding for SEF as proposed at Third Revised Page No. 19K of PPLEU's Supplement No. 38 at a rate of 0.01cents per KWH is just and reasonable and consistent with the public interest. Judge Turner's recommendation that the "Commission adopt the Company's SEF proposal" should be approved. No consideration should, however, be given to the setting of declining funding levels. SEF's Exception No. 1 as presented herein should be granted.

Respectfully submitted,



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DATED: November 12, 2004
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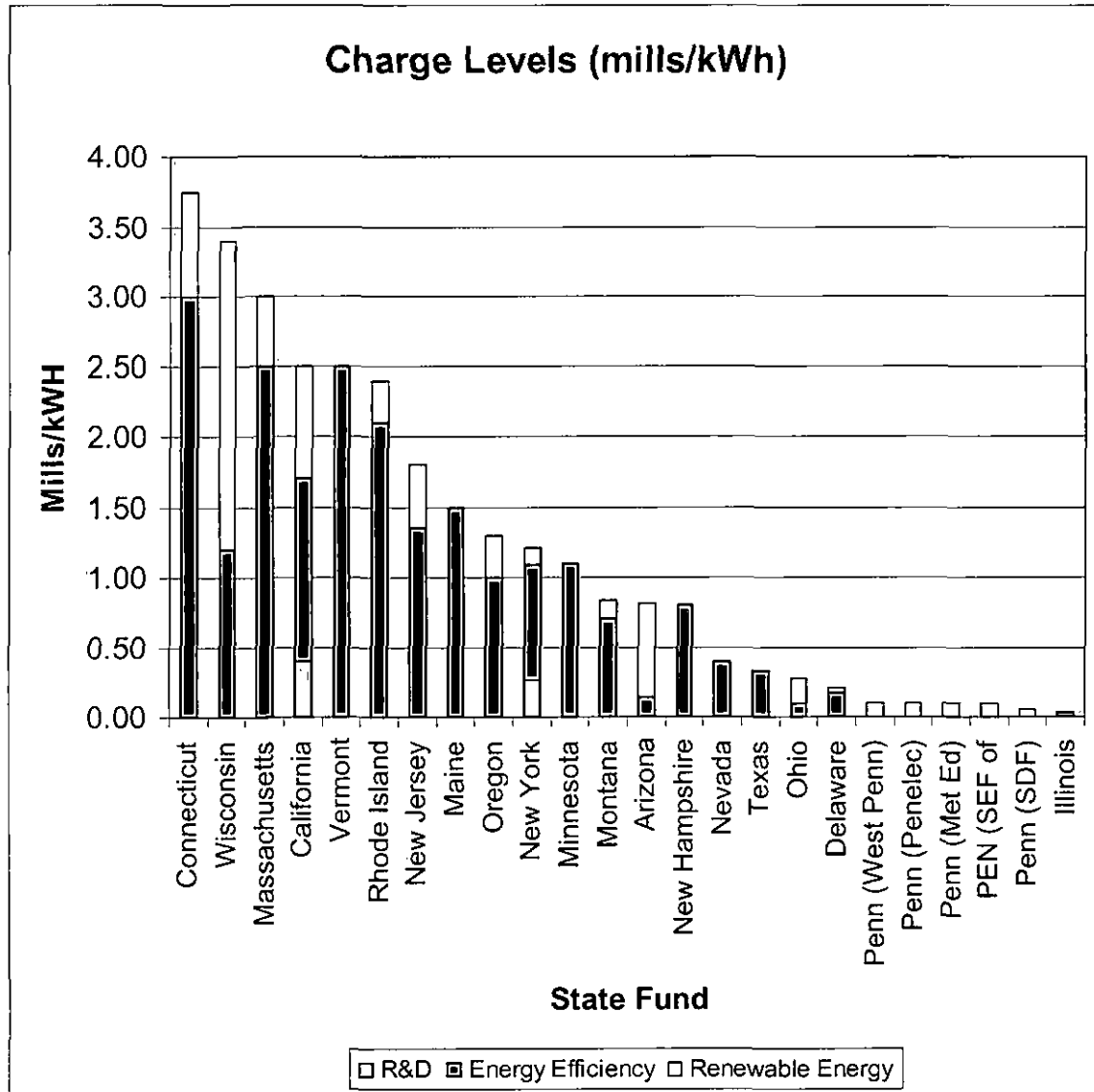
**Attachment C
to SEF Statement No. 1**

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COMPARISON OF MILL LEVY CHARGES FOR STATE SBC FUNDS



Before the
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Administrative Law Judge Allison K. Turner Presiding

Pennsylvania Public Utility Commission : **Docket No. R-00049255**
: :
: :
: :
: :
: :
PPL Electric Utilities Corporation :

v.

SECRETARY'S BUREAU

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CERTIFICATE OF SERVICE

I hereby certify that I have this 12th day of November, 2004, served a true and correct copy of the Exceptions of The Sustainable Energy Fund of Central Eastern Pennsylvania to the Recommended Decision of Administrative Law Judge Turner, upon the persons and in the manner set forth below:

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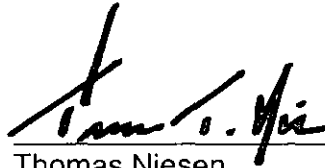
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November 12, 2004

VIA HAND DELIVERY

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Harrisburg, PA 17120

RE: Pennsylvania Public Utility Commission, et al., v. PPL Electric Utilities Corporation; Docket No. R-00049255 C0001-0015

Dear Secretary McNulty:

Enclosed please find the original and nine (9) copies of the Exceptions of the PP&L Industrial Customer Alliance ("PPLICA") in the above-referenced proceeding.

As evidenced by the attached Certificate of Service, all parties to the proceeding are being served with a copy of this filing. Please date stamp the extra copy of this transmittal letter and kindly return it to our messenger for our filing purposes. Thank you.

Very truly yours,

McNEES WALLACE & NURICK LLC

By *Vasiliki Karandrikas*

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Enclosures

- c: Administrative Law Judge Allison K. Turner (via E-mail and First Class Mail)
- Cheryl Walker Davis, Esq., Office of Special Assistants (via Hand Delivery) (with diskette in Word 6.0 format)
- Certificate of Service

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

Pennsylvania Public Utility Commission, :
et al., :
Complainants, :
v. : Docket No. R-00049255 C0001-0015
PPL Electric Utilities Corporation, :
Respondent. :

**EXCEPTIONS OF THE
PP&L INDUSTRIAL CUSTOMER ALLIANCE- COMPLAINANT**

Agere Systems, Inc.
Air Products and Chemicals, Inc.
ALCOA, Inc.
Anvil International, Inc.
Armstrong World Industries
Binkley & Ober, Inc.
BOC Gases
Certainteed Corporation
Cinram Manufacturing
Hercules Cement Co. LP,
d/b/a Buzzi-Unicem USA

Hershey Foods Corporation
Lafarge North America
Magee Rieter Automotive Systems
Nestlé Waters North America and Nestlé
Purina Pet Care
Praxair, Inc.
RR Donnelley & Sons Company
Stroehmann Bakeries
Timet, Inc.
Wegmans Food Markets, Inc.

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Dated: November 12, 2004

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I. INTRODUCTION

On March 29, 2004, PPL Electric Utilities Corporation ("PPL" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 38 to Tariff Electric-Pa. P.U.C. No. 201 ("Supplement No. 38") to become effective on June 1, 2004. Supplement No. 38 proposed to increase PPL's retail distribution rates by \$164.6 million. PPL also informed the Commission that the transmission costs reflected in retail rates are likely to increase by approximately \$57.2 million as of January 1, 2005, and requested to institute a reconcilable, uniform cents per kilowatt-hour ("kWh") Transmission Service Charge ("TSC") to collect transmission and ancillary service charges from retail customers. The combination of proposed distribution and projected transmission rate increases would generate an overall increase of approximately \$221.6 million.

The PP&L Industrial Customer Alliance ("PPLICA"), an active party in this proceeding, is an ad hoc coalition of large, energy-intensive industrial and commercial consumers of electricity located within PPL's service territory.¹ The members of PPLICA are listed on the cover of these Exceptions. PPLICA members purchase service from PPL primarily under Rate Schedules LP-4, LP-5, LP-6, IS-P, IS-T, as well as available riders. PPLICA will refer to customers on these rate schedules generally as "Large Commercial and Industrial" or "Large C&I" customers. PPLICA members use substantial volumes of electricity in their manufacturing processes and the cost of electric utility services is a significant element of operation costs for PPLICA members. Collectively, PPLICA members consume over 2.2 billion kWh of electricity in PPL's service territory.

¹ The PP&L Industrial Customer Alliance is the correct name of the coalition, rather than the PPL Industrial Customer Alliance as reflected in the caption used by the Commission. By letter submitted on June 22, 2004, PPLICA requested that all documents issued by the Commission use PPLICA's correct name, the "PP&L Industrial Customer Alliance," as PPLICA's Complaint was docketed.

Pursuant to the procedural schedule, parties submitted Direct, Rebuttal and Surrebuttal Testimony in this proceeding, and evidentiary hearings were held the week of August 9, 2004. In addition to submitting Direct, Rebuttal and Surrebuttal Testimony, as well as participating in evidentiary hearings, PPLICA filed a Main Brief ("MB") and a Reply Brief ("RB") in order to address several matters at issue in this proceeding. Based upon the record evidence presented, on October 21, 2004, Administrative Law Judge ("ALJ") Allison K. Turner issued her Recommended Decision ("RD") in this proceeding.

II. SUMMARY

PPLICA supports the ALJ's finding that PPL's proposed Distribution System Improvement Charge ("DSIC") should be rejected on the basis that the Commission lacks statutory authority to fashion such rate mechanisms. RD at 43. PPLICA further supports the ALJ's finding that PPL's claim for deferred, amortized Automatic Metering Reading ("AMR") displacement costs should be rejected. Id. at 62. Notwithstanding, PPLICA files these Exceptions to request that the Commission reject several of the ALJ's recommendations. Specifically, PPLICA respectfully submits that:

- The ALJ errs in finding that the rate cap provisions provided under Section 2804(4) of the Competition Act do not bar the Company's claims for deferred amortized Hurricane Isabel costs and AMR displacement costs. Both the Commission and the Commonwealth Court have held that the deferral of costs incurred during a rate cap period for recovery after the rate cap period contravenes the rate cap protection afforded to ratepayers by the Competition Act. Accordingly, the Commission should reverse the ALJ's recommendation and reject PPL's proposal to amortize and recover approximately \$15 million in deferred Hurricane Isabel costs. See infra Section III.A.
- The ALJ errs in recommending that PPL distribution ratepayers should fund the Sustainable Energy Fund ("SEF"). Contrary to the ALJ's findings, the record evidence in this proceeding shows: that PPL's proposed SEF surcharge is an indirect tax, which the PUC lacks authority to impose; that the "demonstrable benefits" standard set forth in relevant legal precedent is, in fact, applicable to PPL's SEF proposal; and that the cost of SEF funding is not a distribution-related cost that may be collected via the Company's distribution rates. Accordingly, the Commission should reverse the ALJ's recommendation and reject PPL's proposal

to mandate ratepayer funding of the SEF via distribution rates. See infra Section III.B.

- The ALJ errs in recommending a return on equity ("ROE") of 10.25%. Office of Consumer Advocate ("OCA") witness Kahal's analysis and recommendation represent the best advice to the Commission. Therefore, the Commission must reverse the ALJ's recommendation and adopt an ROE of 9.5% and an overall rate of return ("ROR") of 7.85%. See infra Section III.C.
- The ALJ errs in recommending adoption of PPL's transmission service charge ("TSC") proposal. The ALJ's recommendation is based on the mistaken belief that adherence to cost causation principles must be sacrificed in the name of rate stability and that the "simplicity" of PPL's TSC proposal will, in and of itself, promote shopping. However, PPL's TSC proposal represents an unjust, unreasonable and unduly discriminatory allocation of the Company's transmission-related costs. Therefore, the Commission must reverse the ALJ's recommended adoption of PPL's TSC proposal and in its place adopt PPLICA's alternative TSC proposal that presents a "middle ground" reflecting cost causation principles and accommodating concerns for rate stability in a just and reasonable manner. See infra Section III.D.
- The ALJ errs in recommending the adoption of PPL's distribution revenue increase allocation, which preserves and, in some cases increases, the subsidies inherent in the Company's distribution rates. The Commission should use this first distribution base rate proceeding to demonstrate its commitment to removing intraclass subsidies and bringing all distribution rates closer to cost. As such, PPL's proposal is unjust and unreasonable. By contrast, PPLICA's proposal ensures just and reasonable rates for all PPL customers by eliminating the subsidization problem and ensuring that customers gradually pay rates based on cost of service. Thus, the Commission must reverse the ALJ's recommendation with respect to PPL's proposal and in its place adopt PPLICA's just and reasonable distribution revenue increase allocation proposal. See infra Section III.E.
- The ALJ errs in failing to address PPLICA's objections to the Company's proposed revisions to PPL Tariff Rule 5A. Specifically, PPL's proposed revisions not only seem to be unsupported by PUC precedent, but also to unlawfully limit the Company's duty to provide the quality of electric service required by the Public Utility Code. Therefore, the PUC must reject PPL's proposed revisions to Tariff Rule 5A as unjust and unreasonable. See infra Section III.F.

Finally, PPLICA respectfully requests that the Commission clarify that PPL, as the proponent of the rate change at issue in this proceeding, bears the burden of proving the justness and reasonableness of each component of its rate request. At the outset of the Recommended Decision, ALJ correctly states:

[I]t is well settled at the Commission and in the courts that the utility's burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one that remains with the public utility throughout the course of the proceeding. This burden does not shift to intervenors challenging a rate request. There is no similar burden placed on an intervenor to disprove a company's claim.

RD at 8 (emphasis added). However, the ALJ subsequently states that:

[P]arties challenging the Company's proposed rate structure and cost allocations with cost of service studies of their own, and proposed different cost allocations, also have a burden of proof, as if they were complainants against the Company's proposals.

Id. at 9 (emphasis added). Based on these contradicting assertions, PPLICA is gravely concerned that opponents' views and proposals challenging the justness and reasonableness of PPL's rate filing may have been disregarded by virtue of a misapplication of the burden of proof. This appears to be most evident in the section of the Recommended Decision addressing the TSC proposals. Accordingly, PPLICA urges the Commission to be particularly critical of the reasoning and record evidence underlying the ALJ's Recommended Decision.

III. EXCEPTIONS

A. **Exception 1: The ALJ Errs in Finding That Rate Cap Provisions Provided Under Section 2804(4) of the Competition Act Do Not Bar PPL's Claim for Deferred, Amortized Hurricane Isabel Costs and AMR Displacement Costs (RD at 47-53).**

According to the Recommended Decision, the rate cap provisions provided under Section 2804(4) of the Competition Act do not bar PPL's claim for \$15 million in deferred, amortized Hurricane Isabel costs. See RD at 53.² The ALJ contends that, pursuant to Section 2804(4) and the PPL Restructuring Settlement: "After expiration [of the rate cap], all expenses normally included for ratemaking purposes may be included in rates to be put into effect after the rate cap expires. Before expiration, none may be collected unless they fit under an exception." Id. On

this basis, the ALJ erroneously reasons that, because PPL's claim did not fit under an exception and qualify for recovery during the rate cap period, PPL may recover Hurricane Isabel costs upon expiration of the rate cap in 2005. *Id.* at 52. Both the Commission and the Commonwealth Court, however, have held that the deferral of costs incurred during a rate cap period for recovery after the rate cap period contravenes the rate cap protection afforded to ratepayers by the Competition Act. Accordingly, the Commission should reverse the ALJ's recommendation and reject PPL's proposal to amortize and recover approximately \$15 million in deferred Hurricane Isabel costs. The Commission should also affirm that the rate cap provisions under Competition Act Section 2804(4) preclude PPL's claim for AMR displacement costs.

As discussed more fully in PPLICA's Main Brief, PPL's amortization and recovery proposal for Hurricane Isabel costs and AMR displacement costs, which the Company incurred in 2003 during the rate cap period, would constitute a *de facto* rate cap exception in violation of the transmission and distribution rate cap protections mandated by Section 2804(4) of the Competition Act and extended voluntarily by the Company through December 31, 2004, pursuant to the PPL Restructuring Settlement. *See generally* PPLICA MB at 31-36. Specifically, both the Commission and the Commonwealth Court have held that the deferral of costs incurred during a rate cap period for recovery after the expiration of the rate cap period would result in recovery exceeding the rate cap. In a proceeding involving the former GPU Energy Companies' request for Commission approval for the deferral of purchased power costs incurred to meet their Provider of Last Resort obligations, the Commission stated:

[T]he Commission recognized that by seeking approval to recover amounts above the existing rate caps for service rendered now through a mechanism designed to defer collection of those amounts until a later time, the Companies are effectively seeking permission to exceed the rate caps.

(continued footnote)

² The ALJ recommends rejection of PPL's AMR severance claim on other grounds; however, because the interpretation of the rate cap under Section 2804(4) applies to both issues, PPLICA includes the AMR severance costs in this Exception.

[...]

We continue to believe that it is necessary for the Companies to meet the requirements of the Act before they can be permitted to recover, in whatever form, rates in excess of the rate caps... Therefore, we will clarify that the Companies must meet the requirements of the Act, regarding rate cap exceptions for either present or deferred recovery of rates which exceed the rate cap for service rendered during the rate cap period.

Id. at 33. The former GPU Energy Companies appealed the Commission's holding, but the Commonwealth Court affirmed that a deferral of costs during the rate cap period allows recovery in excess of the rate cap and must meet the standards for a rate cap exception. Id. at 34.

In ARIPPA v. Pa. Pub. Util. Comm'n, 792 A.2d 636, 663-666 (Pa. Commw. 2002), involving the former GPU Energy Companies' proposed Deferral Tracking Mechanism ("DTM"), the Commonwealth Court found that the DTM would not constitute an exception to the rate cap. In addressing the DTM, the Commonwealth Court characterized the deferral mechanism as follows:

Intervenors contend that the Commission erred in granting a rate increase above the rate caps in the guise of the DTM because it did not meet the requirements for relief from rate cap limitations under § 66 Pa.C.S.A. § 2804(4)(iii)(D)....

Id. Because the requirements for a rate cap exception had not been met, the Commonwealth Court held that it was "plainly erroneous for the Commission to allow revenues to be increased above the legislatively mandated rate caps." Id. Although the Commission was willing and believed that it had the authority to approve a certain ratemaking treatment for the costs, the Commonwealth Court ruled that the Commission's ratemaking discretion did not extend to practices or mechanisms that allow future recovery for costs incurred during the rate cap period. The same logic applies to any action by this Commission to allow PPL to defer and recover the amortized Hurricane Isabel and AMR displacement costs, even if allowing such recovery would be consistent with the PUC's ratemaking discretion under its "long standing practice of allowing

a Company to collect some compensation for extraordinary or abnormal, large historic costs through amortization." See RD at 51.

The ALJ correctly determined that PPL's claim for Hurricane Isabel costs did not constitute an exception to the rate cap. Id. at 52. However, the ALJ incorrectly determined that such costs – incurred during the rate cap period – may be recovered upon the expiration of the rate cap period. The ALJ's determination is clearly contrary to Commission and Commonwealth Court precedent. Accordingly, the Commission should reverse the ALJ's recommendation and reject PPL's proposal to amortize and recover approximately \$15 million in deferred Hurricane Isabel costs, as well as affirm that Section 2804(4) of the Competition Act also bars PPL's claim for AMR displacement costs.

B. Exception 2: The ALJ Errs in Recommending That Distribution Ratepayers Should Fund the Sustainable Energy Fund, as PPL's Proposal is Unjust, Unreasonable and Unlawful (RD at 77-88).

In her Recommended Decision, the ALJ recommends that PPL ratepayers should be required to fund the Sustainable Energy Fund through their distribution rates until December 31, 2009, despite record evidence in this proceeding that shows PPL's proposal is unjust, unreasonable and unlawful. See RD at 87. The ALJ fails to rigorously engage the record evidence in order to evaluate whether PPL has met its burden of proving that the Company's proposal is just and reasonable. Rather, the ALJ's recommendation appears to rely heavily on SEF's Main Brief, which merely "provided many examples of projects it has contributed to or plans to develop," and the unsubstantiated policy arguments set forth therein. Id. at 82. This may be due to the ALJ's apparent misunderstanding that the SEF is part of PPL:

PPLICA asserts that the Company should not collect funds from ratepayers on a mandatory basis to be used to establish and support an essentially private organization. The ALJ agrees with this basic principle. SEF does seem to have itself set up to operate in the market as a private non-profit corporation when it becomes independent from PPLEU. And this independence and the timing of it are truly another aspect of this dispute.

Id. at 87 (emphasis added). The record evidence and the legal arguments set forth in this proceeding demonstrate that PPL's proposal for ratepayer funding of the SEF via distribution rates is unjust, unreasonable and unlawful. Accordingly, for the reasons set forth below and detailed in PPLICA's briefs, the Commission must reject the ALJ's recommendation. See PPLICA MB at 9-30; PPLICA RB at 36-39.

1. The ALJ Errs in Finding That the SEF Surcharge Does Not Serve as a Hidden Tax That the Commission Lacks Authority To Impose.

According to the ALJ, the SEF surcharge "is obviously not a hidden tax, because SEF is quite open an above board." RD at 81. The ALJ fails not only to engage PPLICA's arguments on this point, but also to articulate the legal underpinnings of her conclusion. As detailed in PPLICA's Main Brief, PPL's proposal to extend SEF funding amounts to a surrogate for taxpayer funding of Pennsylvania's renewable and sustainable energy technologies industries. PPLICA MB at 13. The SEF surcharge is a tax because it is not related to PPL's provision of distribution service to customers; rather, it represents a mandatory subsidization of a separate organization by PPL's ratepayers. The Commission lacks the authority to impose taxes. Id. at 14-16. Moreover, if the Pennsylvania General Assembly has declined to impose a tax to fund the SEF, and it is taxpayer funding that the SEF seeks, it should lobby the Legislature, not the Commission. Id. at 14. While PPLICA does not oppose PPL continuing its current voluntary funding of SEF as the Company has done since 1998, or giving customers the option to fund the SEF using a check-the-box approach on each monthly bill or other similar, voluntary funding approaches, PPL ratepayers must not be forced to fund the SEF through an indirect energy tax. Therefore, the Commission must reject PPL's SEF proposal.

2. The ALJ Errs in Finding That the "Demonstrable Benefits" Standard Set Forth in Applicable Precedent Is Inapplicable to PPL's SEF Proposal.

Although the ALJ indicates that the SEF will benefit distribution ratepayers, she finds the "demonstrable benefits" standard applied by the Commonwealth Court to be inapplicable to PPL's SEF proposal. See RD at 77, 87. As PPLICA argued in its Main Brief, applicable precedent requires that ratepayer dollars can be used only for social programs that do produce demonstrable benefits for such ratepayers. See PPLICA MB at 17-28.³ For example, in the Company's last rate proceeding, the Commission disallowed PPL's proposal to fund with ratepayer dollars several social programs designed to "promote the effective usage of electricity and economic development." Id. at 17-18. The Commission held:

While we believe the shareholders, if they so choose, can fund any and all social programs of their choice, we believe that Commission-sanctioned funding is not appropriate when there is no demonstrable benefit to PP&L's customers.

[...]

These socio-economic programs, to the extent they do not provide demonstrable benefits in light of costs to PP&L customers, are socio-economic decisions...that should be left to the legislative branch of the government. Such purely socio-economic decisions, devoid of any demonstrable cost benefit to a utility's customers, are not the appropriate role for this Commission.

Id. at 18. In reaching this conclusion, the Commission was following applicable Commonwealth Court precedent in U.S. Steel Corp. v. Pa. Pub. Util. Comm'n, 37 Pa. Commw. 173, 185, 390 A.2d 865, 871(1978). Thus, contrary to the arguments of SEF, which appear to be cited with approval on pages 85-86 of the Recommended Decision, the PUC itself recognized that

³ The ALJ objects to PPLICA's categorization of the SEF proponents as bearing the burden of proof. See RD at 82. If the PUC views PPL as having the burden of proof, then the record is clearly devoid of sufficient evidence to approve the Company's proposal. See PPLICA MB at 17-28 (discussing PPL's arguments). Even the "evidence" presented by other proponents of SEF funding is legally inadequate to demonstrate that this item should be included in PPL's distribution cost of service and rates.

applicable precedent requires both a demonstration of benefits for ratepayers and a showing that those benefits outweigh the costs.

The ALJ concedes that the SEF has yielded virtually no benefits in the area of wind generation, which has been the SEF's "major theme" to date. RD at 83, 87. The ALJ stated, "PPLICA has very effectively demolished the Bear Creek Wind Farm evidence, and exposed its failing to show a viable project that will return benefits soon." Id. at 87. Nonetheless, the ALJ appears to find that the SEF has benefited PPL's distribution customers without referencing the record evidence supporting this finding. Id. at 77. In its Main Brief, PPLICA presents detailed arguments discrediting the purported benefits of the SEF propounded by PPL and the parties supporting PPL's proposal. Specifically, PPLICA demonstrates that:

- (1) The SEF's energy and conservation management demand-side projects produce no demonstrable benefits to PPL distribution ratepayers, PPLICA MB at 21-23;
- (2) The SEF's distributed generation projects produce no demonstrable benefits to PPL distribution ratepayers, id. at 23-25;
- (3) The SEF's wind farm projects produce no demonstrable benefits to PPL distribution ratepayers, id. at 25-27; and
- (4) Advances to public policy goals of encouraging renewable energy are not demonstrable benefits for distribution ratepayers, id. at 27-28.

The only "benefits" evidence cited by the ALJ is SEF's support of two other wind farms, several biomass digesters, the LEED-certified green building programs and a failed attempt to relocate an electric vehicle company in Scranton. See RD at 85, 87. The arguments raised by PPLICA in briefs demonstrate the minimal (if any) benefit of the wind farms to PPL ratepayers. See PPLICA MB at 25-27; PPLICA RB at 36-39. PPLICA respectfully submits that the Commission must also seriously question the benefits of the other projects and whether those

benefits outweigh the \$3 million per year in funding that the SEF has received and would continue to receive under the ALJ's recommendation.

Contrary to the ALJ's erroneous conclusion, applicable precedent clearly requires that the proponents of a social program must prove that it yields "demonstrable benefits" in order to receive funding through ratepayer charges. In the instant proceeding, PPL fails to show that SEF-subsidized projects have yielded demonstrable benefits for the Company's distribution customers. Accordingly, the Commission must reject PPL's proposal for continued funding of the SEF through customer distribution rates.

3. The ALJ Errs in Finding That the SEF Should Be Included in PPL's Distribution Rates, as the Cost of Funding the SEF Is Not Distribution-Related.

Implicit in the ALJ's erroneous recommendation that PPL's SEF proposal be approved by the Commission is the equally erroneous finding that the cost of funding the SEF is a distribution-related cost. See PPLICA MB at 28-30. It is axiomatic that only expenses related to distribution service should be included in distribution rates. The projects funded by SEF dollars do not, in any manner, enhance or relate to the distribution service provided to PPL customers. Moreover, in light of the fact that rate unbundling was designed to eliminate all non-distribution costs from distribution rates, it would be illogical to begin reinserting generation-related costs in distribution rates in the restructured environment. Id. at 28-29.

The benefits, if any, of the SEF projects relate to generation service. Because the General Assembly determined that generation service should be subject to competitive market forces, the competitive market must decide the extent to which SEF-type entities and projects will be supported. See PPLICA MB at 9-10, 24-25; PPLICA RB at 36-39. In the alternative, the Legislature can use its taxation powers to subsidize entities and projects such as the SEF in the Commonwealth's budget. While other parties have attempted to sidestep this fundamental issue, the fact remains that PPL has failed to demonstrate that the SEF is a distribution-related cost and,

consequently, that such costs may be collected via distribution rates. Therefore, the Commission must reject PPL's proposal for continued SEF funding through distribution rates.

C. Exception 3: While PPLICA Supports the Rejection of PPL's Proposed 11.5% ROE, the ALJ Errs in Recommending a 10.25% ROE (RD at 101-122).

According to the Recommended Decision, a 10.25% ROE is "the most appropriate DCF result produced for this case." RD at 122; see generally id. at 94-122. The ALJ bases this recommendation on her perception that Department of Defense witness Kinzel was most persuasive as to "why his application of the DCF method corrected for the problems in the method." Id. at 119. In establishing PPL's ROE, the focus should be on which proposal most accurately reflects the appropriate ROE for PPL's distribution business. See PPLICA MB at 37-38. As PPLICA explained in its Main Brief, OCA witness Kahal's analysis and recommendation represent the best advice to the Commission on the ROE and overall ROR for the Company. Therefore, the Commission should adopt the OCA's proposed ROE of 9.5% and overall ROR of 7.85%.

D. Exception 4: The ALJ Errs in Recommending Adoption of PPL's TSC Proposal, which is Unjust, Unreasonable, Discriminatory and Contrary to the Public Utility Code and PPL's Tariff (RD at 124-140).

In the Recommended Decision, the ALJ erroneously recommends adoption of PPL's TSC proposal pursuant to which the Company seeks to recover transmission costs by the imposition of a \$0.0564/kW adder. See RD at 124-140. The ALJ's reasoning for adopting PPL's TSC proposal reflects a mistaken belief that adherence to cost causation principles must be sacrificed in the name of rate stability, id. at 137-139, and that a uniform TSC rate, in and of itself, will promote shopping, id. at 139. Due to the fundamental flaw in PPL's proposal, which modifies the current demand-based allocation of transmission costs to an energy-based allocation, no valid basis exists to conclude that PPL has satisfied the burden of proof that its TSC is just, reasonable and consistent with the Public Utility Code. See PPLICA MB at 69-75.

As discussed at length in its briefs, PPLICA's alternative TSC proposal, based on a cost-based allocation of transmission and ancillary service costs that tracks PPL's own procedures to determine obligations for customers that access competitive generation supply, is the best method available at this time to allocate cost responsibility among rate schedules and customers.

See generally PPLICA MB at 61-86; PPLICA RB at 3-22.

Moreover, upon proper allocation of the Company's transmission costs, the potential annual TSC variation can be accommodated on a rate schedule basis; it should not preclude the Commission from adhering to cost causation principles. See PPLICA RB at 20-22. Finally, the mere "simplicity" of PPL's TSC proposal is not sufficient to promote shopping; rather, only a TSC proposal that fosters the creation of a level playing field between customers and Electric Generation Suppliers ("EGS") will realize the Competition Act's objective of a truly competitive retail market. Id. at 17-20. Accordingly, the Commission must reject PPL's TSC proposal, which results in an unjust, unreasonable and unduly discriminatory allocation of PPL transmission revenue requirements, particularly with respect to Large C&I customers, in favor of PPLICA's alternative TSC proposal, which presents a "middle ground," reflecting cost causation principles and accommodating concerns for rate stability in a just and reasonable manner.

1. PPL Failed To Satisfy The Burden Of Proof That Its TSC Proposal Is Just, Reasonable, And Otherwise Consistent With The Public Utility Code.

As the ALJ appears to recognize, PPL bears the ultimate burden of proof with respect to its proposals. See RD at 7-9. Based on the evidence presented in this proceeding, no valid basis exists to conclude that PPL has carried the burden to prove that its TSC proposals are just, reasonable and consistent with the Public Utility Code. As a result, the ALJ's recommendation to adopt PPL's TSC proposals must be rejected.

First, the Public Utility Code requires PPL to provide transmission service to customers at rates that are consistent with the Company's own use of the transmission system. See 66

Pa.C.S. §2804(6). The undisputed evidence shows that, for large customers with demand metering, PPL (or the alternate EGS serving the customer) is charged for transmission service on a demand basis. See PPLICA MB at 67-68. Although PPL may receive only a single transmission bill from PJM that includes all POLR customers, PPL is able, when a customer shops, to segregate that customer's transmission obligation for payment by the EGS. Under Section 2804(6), PPL is required to charge customers for transmission service consistent with this procedure. PPL's TSC proposals fail to do so and are inconsistent with the Public Utility Code.

Second, PPL's own tariff requires that it provide and charge for transmission service consistent with the PJM Open Access Transmission Tariff. See PPLICA MB at 71-72. As explained in PPLICA's Main Brief, PPL's TSC proposals are not consistent with the costs incurred by PPL from PJM for transmission service to larger customers. As a result, PPL's TSCs violate the Company's tariff.

Third, PPL has changed the allocation methodology for transmission costs. Transmission costs currently are allocated among customer classes on a demand basis to reflect cost causation. Tr. at 985 (Kleha). To minimize the portion of the transmission rate increase that will be assigned to residential customers, PPL proposes to fundamentally change allocation methodologies for transmission costs to an energy basis, which has little relation to the underlying service costs. See PPLICA MB at 70-71. This is not a proper motivation for a cost allocation proposal and must be summarily rejected.

Fourth, PPL's proposal results in large customers bearing a disproportionate amount of the transmission increase. The system average transmission increase proposed by PPL is 40.3%; however, customers on Rate Schedules LP-4, LP-5, IS-T, and IS-P will experience transmission rate increases in the range of 55% to 80% with other rate schedules experiencing transmission rate decreases. See PPLICA MB at 73-74. Because this disparate treatment cannot be

supported by valid cost causation or other ratemaking reasons, the resulting transmission rates for large customers are unjust, unreasonable and unduly discriminatory. See PPLICA RB at 21.

These flaws and the other items discussed in PPLICA's Main and Reply Briefs render all of PPL's TSC proposals inappropriate and unlawful. The ALJ's failure to recognize PPLICA's objections and recommend rejection of PPL's TSC proposals clearly is in error. PPLICA respectfully requests that the Commission reject the ALJ's recommendation and adopt PPLICA's TSC.

2. The ALJ Erroneously Reasons That Adherence To Cost Causation Principles Must Be Sacrificed in the Name of Rate Stability.

As argued in PPLICA's Main Brief, sound principles of cost causation and rate making militate in favor of allocating and recovering transmission and ancillary services costs from PPL's ratepayers in a manner that mirrors PJM Interconnection, L.L.C.'s ("PJM") allocation methodology and billing procedures. The allocation of transmission and ancillary services costs among PPL's rate schedules should recognize that nearly 70% of the Company's transmission costs are demand-related and that the remaining 30% are energy-related. PPLICA MB at 67-69. Given that the cost basis for the Company's transmission costs are readily identifiable, the allocation of transmission and ancillary services costs among PPL's rate schedules should reflect the demand and energy nature of the costs incurred by PPL from PJM in order to avoid interclass shifting of cost responsibility. Id.

As PPLICA discussed in its Reply Brief, both the Company and the OCA inconsistently argue that the cost of service study is critical to setting distribution rates, but should be ignored in setting PPL's transmission rates. For example, PPL argued:

The Commission has repeatedly recognized that cost of service is only a guide to designing rates and is only one factor, albeit an important one, to be considered in the rate setting process. *See, e.g., Pa. P.U.C. v. Pennsylvania Power & Light Co.*, 55 PUR 4th, 185, 249 (1983) (describing cost of service of service [sic] study as a "useful tool" for testing reasonableness of a proposed

allocation). Moreover, cost of service analysis is not an exact science, and there is no single, absolutely correct method. *See id.* (describing cost of service study as "engineering art"); PPL Electric St. 5-R, p. 2. But consistency in cost allocation is indisputably important for PPL Electric and its customers, and PPL Electric has used the same methods of cost allocation here which have been approved by the Commission in prior PPL Electric rate proceedings.

PPLICA RB at 9-10 (quoting PPL MB at 161-162). Similarly, the OCA argued:

The cost of service study serves as a guide used to set rates consistent with the principle of cost causation. It is critical that the cost of service study relied upon to guide the setting of rates be as accurate as possible. The OCA submits that there are significant flaws in the Company's study making it an unreliable indicator of the cost to serve any particular class. As discussed below, the OCA has proposed an alternative to the Company's cost of service study that more accurately reflects the cost to serve the various classes. The OCA's cost of service study should be used as the guide in this proceeding.

Id. at 10 (quoting OCA MB at 103). As PPLICA explained in its Reply Brief, the same arguments raised by PPL (with respect to using consistent allocators from prior cases) and by the OCA (with respect to how the choice of an alleged incorrect allocator can significantly overstate the cost to serve customer classes) require rejection of PPL's TSC and adoption of PPLICA's proposal instead. See PPLICA RB at 9-12. The fact that the TSC is an automatic adjustment mechanism similar to Purchased Gas Cost rates does not eliminate the necessity of allocating costs and designing the rate to reflect proper cost allocation. See id. at 12-13.

The ALJ also includes in the Recommended Decision a detailed description of the standards and steps for setting rate structure. See RD at 140-142. Yet, with respect to transmission rates, the ALJ ignores the standards by: (1) not relying on a valid cost of service study or analysis as performed by PPLICA's witness Mr. Baron; (2) not allocating the transmission rate increase across rate classes based on costs; (3) not minimizing interclass and intraclass subsidization; (4) not avoiding sharp increases and requiring some customers to experience increases of 80% in transmission rates; and (5) not requiring differences in

transmission rates for different customer classes where there is a reasonable and legitimate basis to develop different rates. Under years of ratemaking precedent, the fact that a proposal such as PPL's uniform TSC may be "gradual for the bulk of its ratepayers" (RD at 139) does not sanction such a significantly unfair and unreasonable allocation and rate design for transmission costs.

In this proceeding, PPLICA submits an alternative TSC proposal that more accurately reflects cost causation and is just and reasonable:

*A TSC that is allocated (and ultimately recovered) consistent with the cost basis associated with each of the transmission-related charges PPL incurs pursuant to the PJM OATT would produce a just and reasonable allocation of the Company's transmission costs. To that end, PPLICA proposes to directly allocate demand- and energy-related transmission charges from PJM to individual PPL rate schedules. PPLICA Statement No. 1 at 18, 22. Pursuant to PPLICA's alternative TSC proposal, the Company's transmission revenue requirement must first be classified into demand and energy components. Second, a demand-related TSC ("TSC-D") and an energy-related TSC ("TSC-E") must be developed to distinguish transmission costs on an energy and demand basis. Third, the TSC-E and the TSC-D charges must be applied to each rate schedule to determine each rate schedule's share of transmission costs. Thereafter, individual rate schedule transmission revenue requirements can be calculated on both an energy and demand basis and a corresponding TSC rate can be computed for each rate schedule. For customer classes billed on interval demand meters such as Rate Schedules LP-4, LP-5, IS-P, IS-T and LP-6 customers can be charged directly based on customers' allocated zonal coincident peak demand responsibility and actual kWh consumption (adjusted for any applicable losses). See *id.* at 22-23.*

PPLICA MB at 75. No party in this proceeding – including PPL – disputes that PPLICA's proposal is an accurate application of PJM's allocation methodology and consistent with cost causation principles. *Id.* at 76-77. Importantly, PPLICA's alternative TSC proposal, unlike PPL's TSC proposal, does not force Large C&I customers to absorb a disproportionate portion of the Company's overall transmission increase. *See id.* 73-74.

Any variability in the annual allocation of transmission and ancillary service costs among rate schedules reflects the change in costs resulting from the various customer classes' differing

use characteristics. See PPLICA RB at 21. This result sends economic signals to all customers regarding the impact of their consumption choices on the transmission system, thereby encouraging more efficient consumption by all customers. Id. Unlike PPLICA's alternative TSC proposal, PPL's uniform TSC rate purports to "address" variability, but at the expense of cost causation. Specifically, PPL's TSC proposal results in charging one customer group (e.g., Large C&I customers) disproportionately high rates that are unrelated to that group's usage characteristics or PPL's cost to serve in order to accommodate the stability concerns of another group. As a result, PPL's proposal violates the concept that rates must not be unduly discriminatory between customer classes. Id.

The ALJ errs in recommending adoption of PPL's TSC proposal on the basis of her mistaken belief that adherence to cost causation principles must be sacrificed in the name of rate stability. PPLICA's alternative TSC proposal reflects a transmission cost allocation methodology that addresses certain customers' need for rate stability while observing cost causation principles. Thus, the Commission must reject PPL's unjust, unreasonable and unlawful TSC proposal in favor of PPLICA's alternative TSC proposal.

3. The ALJ Erroneously Reasons That a Uniform TSC Rate, Though Unjust and Unreasonable, Will Promote Shopping.

In the Recommended Decision, the ALJ indicates that her recommendation for approval of PPL's TSC proposal was premised, in part, on the notion that a uniform TSC rate, though unjust and unreasonable, will promote shopping for generation supply among PPL ratepayers. See RD at 139. Interestingly, the ALJ completely fails to mention the testimony of witnesses that actually negotiate competitive supply arrangements. Rather, the ALJ appears to rely on arguments by the Mid-Atlantic Power Supply Association ("MAPSA") that the mere "simplicity" of PPL's TSC rate will assist customers in shopping for generation supply and Mr. Krall's argument that he is unaware of how EGSs may charge competitive customers for transmission.

See RD at 132. MAPSA's and PPL's arguments are misguided; PPL's TSC proposal must be rejected.

As set forth in more detail in PPLICA's Reply Brief:

Five witnesses testified regarding the impact of the transmission rate design on generation supply shopping decisions. Three of those witnesses are energy managers for major PPL customers that are responsible for negotiating competitive generation supply arrangements. See Direct Testimony and Exhibits of Jennifer Hunsperger at 6 (hereinafter, "PPLICA Statement No. 2") (Energy Manager, Northeast Region for Praxiar, Inc., testifying on impact of proper TSC allocation and design on generation supply shopping); Direct Testimony and Exhibits of Larry Stalica at 6-7 (hereinafter, "PPLICA Statement No. 3") (Manager, Energy and Regulatory Affairs for BOC Gases, testifying that Mr. Baron's TSC proposal would promote competition by simplifying the comparison of POLR rates and EGS offers); PPLICA Statement No. 5 at 9 (Mr. Croop testifying on behalf of Anvil regarding the ease of comparing POLR rates with competitive supply offers under PPLICA's proposed TSC). These witnesses testified based on their past experience and, more importantly, their future preference for transmission and ancillary service costs to be a transparent item in the generation supply negotiations—*i.e.*, an item that is nearly identical regardless of whether the facility purchases POLR supply or competitive supply, as contemplated by Section 2804(6) of the Competition Act, 66 Pa.C.S. § 2804(6). If provided the opportunity through the appropriate transmission cost allocation and rate design, these customers will ensure that the transmission and ancillary service rates charged by EGSs are identical to the Federal Energy Regulatory Commission ("FERC")-approved rates paid by the EGS, rather than allowing the EGS to include an unquantified assumption and risk factor for transmission and ancillary service costs as part of the EGS's margin in the competitive offer. This may be a reason that MAPSA has, without providing any testimony on the subject, decided to support the PPL kWh allocation and recovery proposal as a method to "promote competition." See MAPSA M.B., p. 1-3.

PPLICA RB at 18. If the Commission adopts a TSC proposal that inaccurately reflects transmission costs, customers will be deprived of information to make informed choices regarding generation supply offers provided, for example, by MAPSA members. Id. at 19.

In fact, the Competition Act recognizes that transmission service should be comparable regardless of whether the customer purchases POLR supply from PPL as the POLR or an EGS.

Specifically, when PPL provides transmission service, Chapter 28 of the Public Utility Code states that:

Consistent with the provision of section 2806, the commission shall require that a public utility that owns or operates jurisdictional transmission and distribution facilities shall provide transmission and distribution service to all retail electric customers in their service territory and to electric cooperative corporations and electric generation suppliers, affiliated or nonaffiliated, on rates, terms of access and conditions that are comparable to the utility's own use of its system.

66 Pa. C.S. § 2804(6); PPLICA MB at 62. Only PPLICA's TSC is comparable to the underlying PJM transmission service methodology.

Furthermore, the level of current shopping is irrelevant to the decision on how to appropriately allocate and design rates. The PUC clearly anticipates that shopping will increase, and should not take any action to inhibit shopping, especially when addressing an issue such as this for the first time. While the Commission cannot control how EGSs charge customers for transmission service, it can ensure that customers have accurate information in retail rates regarding transmission costs.

To promote customer choice as envisioned by the Competition Act, the Commission must adopt a TSC proposal that establishes a level playing field for negotiations between customers and EGSs. Thus, the Commission must reject PPL's TSC proposal in favor of PPLICA's alternative TSC proposal, modified as discussed below, to "smooth out" the rate variation for customers that need rate stability.

4. The ALJ Failed To Note That PPLICA's Properly Allocated and Designed TSC Will Promote Demand Side Response and Reliability.

As previously stated herein, see supra Section III.D.1, and in briefs, PPLICA's alternative TSC proposal promotes efficient use of electricity and PPL's transmission system. See PPLICA MB 100-101; PPLICA RB 12-15. Specifically, PPLICA presented evidence that its properly allocated and designed TSC will promote demand side response and reliability, thereby

benefiting all customers by reducing the Company's generation costs and overall transmission charges. Conversely, a TSC rate that lacks an accurate cost basis (such as PPL's TSC proposal) actually penalizes large, high load factor PPL customers who are capable of providing demand response and reliability benefits, and otherwise fails to send accurate signals to other users regarding the impact of their consumption decisions on transmission costs. The Commission, therefore, must reject PPL's TSC proposal.

As presented in PPLICA's Reply Brief, PPLICA's alternative TSC proposal will encourage efficiency, as illustrated by the testimony of PPLICA member Anvil International Corporation:

Q. Does PPL's proposed transmission rate design recognize Anvil's demand control activities?

A. No. We will be charged the same rate as all other customers regardless of when we use the electricity or whether Anvil took steps to minimize its usage during on-peak periods. As PPLICA's expert witness Mr. Baron testifies, although the current transmission charge is also assessed on a kWh basis, the allocation of the transmission costs to the various rate schedules was at least accomplished on a kW basis, which would provide some recognition of the demand control activities of any customers within that rate schedule.

Q. Would Mr. Baron's proposed per-kW Transmission Service Charge ("TSC") provide an incentive for Anvil to continue demand controls?

A. Yes.

RB at 13-14. PPLICA member Armstrong World Industries, who also viewed PPLICA's alternative TSC proposal as providing additional incentives to stimulate demand response, explained why PPL's TSC proposal was inferior:

A per KW transmission charge provides an incentive for Armstrong to control our demand during on-peak hours improving our load factor to help increase transmission capacity at peak time. This benefits Armstrong (through lower costs), provide[s] lower costs to the transmission owner by minimizing their investment and provides a benefit to the entire electric grid by giving

Armstrong and other large users an incentive to minimize our usage during peak demand periods. A flat kWh transmission charge as proposed by PPL does not provide the same incentive to avoid using electricity at peak demand time. PPL's per kWh proposed transmission charge also will not provide a demand-side response signal to participate in demand-side response programs offered by PJM and endorsed by FERC.

Id. at 14 (emphasis added).

The establishment of rates that are based on cost causation are necessary to generate economic signals that reflect the impact of customers' choices and, consequently, provide information necessary to maximize the efficiency of such choices. When a customer has an incentive (i.e., potential cost savings) to make economically efficient choices (e.g., pursuit of demand side response), the cost of service to all customers reduces. PPLICA's alternative TSC proposal is based on principles of cost causation and does yield economic price signals. PPLICA's alternative TSC proposal promotes economically efficient customer choices, which ultimately benefit all customers. PPL's TSC proposal falls far short of realizing these goals and providing these benefits. Therefore, PPL's TSC proposal must be rejected in favor of PPLICA's alternative TSC proposal.

5. Other Parties' Objections To PPLICA's Alternative TSC Proposal Are Without Merit.

Contrary to the ALJ's indications and other parties' assertions, PPLICA is not opposed to adopting measures to smooth out any rate variations that may be attributable to the allocation of the Company's transmission costs according to cost causation principles. PPLICA recognized that:

The potential variability in the annual allocation of transmission and ancillary service costs among rate schedules properly reflects the change in cost causation that occurs if different customer classes cause the Company's zonal peak. This sends proper signals to all classes of customers regarding the impact of their consumption decisions on the transmission system, and should encourage more efficient consumption decisions by all customers.

PPLICA RB at 21 (citations omitted). PPLICA further recognized that:

The impact of the potential annual variability in TSC rates obviously is a more important issue for the smaller customers than it is for larger customers. To resolve the competing concerns, the Commission clearly could adopt one of the "smoothing" proposals advanced by the Company or the OSBA for the residential and small commercial customers, while ensuring that the TSC allocation and rate design for large customers accurately tracks the annual changes in transmission and ancillary service cost obligation as proposed by Mr. Baron. This is the appropriate "middle ground" to accommodate all of the concerns expressed by the parties in this matter.

Id. (emphasis added). Thus, PPLICA does not oppose modifying its alternative TSC proposal to address certain customers' need for rate stability.

PPLICA does oppose as unduly discriminatory TSC proposals (such as the ones propounded by PPL and the OSBA) that charge one customer group (i.e., Large C&I customers) a disproportionately high rate unrelated to that customer group's usage characteristics or costs of service in order to accommodate the "stability" concerns of another group. Modifications to address stability can be crafted only after properly allocating costs.

Additionally, the OCA objected to PPLICA's alternative TSC proposal on the basis that it did not "perfectly" assign individual customer transmission and ancillary service cost responsibility for customers who did not possess interval-metering capabilities. See PPLICA RB 15-16. As explained in briefs, PPLICA's alternative TSC proposal is based on the Company's procedures for determining transmission and ancillary service cost responsibility. Id. at 16. The OCA's objection appears to be more accurately directed at PPL's load profiles. Id. The perceived inadequacy of PPL's load profiles is not a sufficient reason to reject the use of actual customer information for the allocation and recovery of transmission and ancillary service costs where such information is available. Id.

As evidenced above and in briefs, other parties' objections to PPLICA's alternative TSC proposal are without merit. PPLICA's alternative TSC proposal is the best available

methodology to allocate transmission and ancillary service cost responsibility to rate schedules and customers.

6. Summary

As demonstrated in this proceeding, PPL's TSC proposal does not distinguish between demand- and energy- based transmission costs, resulting in competitive distortion and cost shifting. PPLICA's alternative TSC proposal avoids such negative consequences by tracking the manner in which the Company incurs its transmission-related costs, consistent with cost causation principles. The superior level of accuracy afforded by PPLICA's TSC proposal is unparalleled. Other parties' objections to PPLICA's alternative TSC proposal are without merit.

As PPLICA summarized in its Reply Brief:

Although ratemaking may involve a multi-factorial analysis by the Commission, cost causation is a preeminent guiding factor. PPLICA's TSC proposal most accurately allocates and recovers the transmission and ancillary service costs on a cost causation basis and minimizes interclass and intraclass cost shifting. In addition, PPLICA's TSC is the only proposal that complies with the statutory requirement that transmission rates and service to POLR customers must be comparable to PPL's own use of the system. See 66 Pa.C.S § 2804(6). Furthermore, PPLICA's TSC advances other ratemaking goals, such as encouraging the efficient use of electricity and enabling customers to make informed decisions regarding future competitive generation supply offers from EGSs. As the OCA recognizes, this is a "first of its kind" case for the Commission in which it is appropriate to examine and implement the most appropriate manner in which to allocate costs. See OCA M.B., p. 117, n.117. Although PPLICA may not agree with the merits of the OCA's proposed changes to PPL distribution COSS, PPLICA does agree that the Commission should strive to ensure that its decisions in this proceeding are based on appropriate cost causation principles. PPLICA's TSC clearly is the superior proposal for the allocation and recovery of transmission and ancillary service costs and should be adopted in this precedent-setting proceeding.

PPLICA RB at 22. Thus, the Commission must reject the ALJ's recommendation to adopt one of PPL's TSC proposals and, in its place, adopt PPLICA's alternative TSC proposal, which is undisputedly consistent with cost causation principles, minimizes interclass and interclass cost

shifting and ensures that retail transmission rate design will not unduly influence customers' generation supply shopping decisions.⁴

E. Exception 5: The ALJ Errs in Recommending Adoption of PPL's Distribution Revenue Increase Allocation and Failing to Begin the Process of Reducing Subsidization of Residential and Streetlighting Customers by all Other Customer Classes (RD at 140-151).

According to the Recommend Decision, PPL's distribution revenue increase allocation should be adopted because it purportedly produces a "reasonable result." RD at 151. However, as detailed in PPLICA's Main Brief, PPL's distribution revenue increase allocation is unjust and unreasonable as it preserves, and in some instances increases, the subsidies inherent in PPL's distribution rates and fails to include a definitive plan to gradually move all rate schedules to cost of service. See PPLICA MB at 87-101. For these reasons, the Commission must reject PPL's distribution revenue increase allocation proposal and, in its stead, adopt PPLICA's proposal.

As discussed in PPLICA's Main Brief, while PPL's filed distribution COSS presents a reasonable basis for determining any rate allocation, the results of the Company's study indicate that significant subsidies are occurring in the Company's current and proposed distribution rates. Id. at 87, 89. By way of illustration, PPLICA stated:

As set forth in Exhibit SJB-6 (attached as Appendix E), PPL's current rates result in residential RS customers receiving a subsidy of \$51 million from the other rate schedules. Moreover, the 1.6% rate of return paid by residential RS customers is less than half of the average system rate of return of 3.91% at present rates. See PPLICA Statement No. 1 at 33-34. This subsidization exists because the current residential distribution rates recover significantly less costs than are properly allocated to these rate schedules; conversely, to keep PPL financially viable, customers on the other rate schedules are paying distribution rates that recover significantly more than the costs that are properly allocated to their rate schedules. PPL's COSS compares the distribution revenues paid by each rate schedule to a cost-based allocation of

⁴ In recognition of the Commission's page limit for these Exceptions, PPLICA has focused on providing the Commission with a concise overview of PPLICA's arguments with respect to the Company's TSC proposal. PPLICA respectfully refers the Commission to PPLICA's Main and Reply Briefs for a thorough discussion of this important and precedent-setting issue.

each component of the distribution revenue requirements. Under this comparison, Large C&I customers are currently paying distribution rates that are significantly above any reasonable measure of cost.

Id. at 90 (emphasis added). The significant subsidies set forth in PPL's COSS have been imbedded in PPL's distribution rates for at least the last ten years. Id. at 89. Even if the modifications to the COSS proposed by certain parties, such as the OCA, were accepted, the reclassification of some distribution costs as demand-related would have no impact on the cost of service for Rate Schedules LP-5, LP-6, IS-T, and LPEP. Id. at 89-90.

Due to the degree of subsidization inherent in PPL's distribution rates, PPLICA contends that any rate allocation adopted by the Commission must address and remediate this subsidy problem. Id. at 94. PPL's proposed distribution revenue increase allocation fails to do so. As previously mentioned, PPL's proposal retains, and in some cases increases, the unjust and unreasonable subsidies inherent in the Company's distribution rates. Id. at 92-95. Moreover, PPL has recognized that "the allocation of distribution-related revenue requirements falls more heavily on customers who take service at lower voltages (i.e., make greater use of the distribution system) than on customers who take service at higher voltages (i.e., rely less on distribution equipment)." Id. at 94. Consequently, if the Commission adopts PPL's proposal, subsidization of residential rate schedules will increase at the expense of Large C&I customers that barely rely on the Company's distribution system. Id.

The significant subsidization in distribution rates that would continue under PPL's proposal makes Large C&I distribution rates unjust, unreasonable, and unduly discriminatory, in violation of Section 1301 of the Public Utility Code. Id. at 94-95. For that reason, PPLICA has presented a rate allocation proposal that would address these problems while also ensuring a gradual removal of the subsidies in order to obviate any rate shock that could otherwise occur. As explained in its Main Brief:

PPLICA's proposal, which is based upon the Company's originally requested \$162 million rate increase, provides for a 50% subsidy reduction for any rate schedule that currently is subsidizing rates for the residential and street lighting rate schedules. In other words, the originally proposed \$162 million increase would be allocated in such a manner as to reduce the subsidies at present rates by 50%. See PPLICA Statement No. 1 at Exhibit SJB-10 (attached as Appendix F). The only exception to this proposal would be for Rate Schedules IS-T and LP-6, for which the Company's proposed rate allocation would be accepted. In order to maintain the 50% subsidy reduction criterion for residential and smaller customer classes, the very small revenue shortfall, associated with adopting the Company's increase proposal for IS-T and LP-6 would be assigned to Rate Schedules LP-4, IS-P, and LP-5. Except for this small adjustment, all of the rate schedules would pay or receive subsidies at proposed rates at approximately 50% of the level (in dollar terms) that exist at present rates. See PPLICA Statement No. 1 at 41-43.

The remaining subsidies could then be mitigated by adjusting rates such that 25% of the additional remaining subsidies are removed in each of the successive years after the first year of the authorized increase approved in this case. Under this approach, 50% of the present rate subsidies would be removed initially, with all remaining subsidies removed by the third year that new rates are in effect. Id. at 44. This recommendation would maintain PPL in a revenue neutral position during this three-year time period, while adjusting the individual class rates for distribution service at the beginning of each successive year over the next three years. As a result, all subsidies would be removed from distribution rates that would be effective at the beginning of the third year. Id.

Id. at 95-96.

Unlike PPL's proposal, PPLICA's distribution revenue increase allocation proposal ensures just and reasonable rates for all customers by eliminating the subsidies inherent in the Company's distribution rates, thereby ensuring that all customers will eventually pay their cost of service. Elimination of subsidies not only promotes efficient use of the Company's distribution system, but also ensures just and reasonable distribution rates, which are critical for Large C&I customers to remain viable in a fiercely competitive national and international marketplace. Therefore, the Commission must reject PPL's proposal in favor of PPLICA's proposal set forth herein and in its briefs.

F. Exception 6: The ALJ Errs in Failing To Address PPLICA's Objection to the Company's Proposed Changes to Tariff Rule 5A.

In the Recommended Decision, the ALJ fails to address PPLICA's objections to the Company's proposed changes to Rule 5A of the PPL Tariff. Specifically, PPL proposes to revise Tariff Rule 5A by adding "clarifying" language that shifts to a customer the onus of purchasing and installing protective devices and alternate power supplies in order to protect the customer's facilities and property. See generally PPLICA MB at 59-61. PUC precedent does not support the Company's proposed changes to Tariff Rule 5A. In fact, the Company's proposed changes appear to unlawfully limit the Company's duty to provide the quality of electric service required by the Public Utility Code. Therefore, PPL's proposed revisions to Tariff Rule 5A are unjust and unreasonable and must be rejected.

As discussed in PPLICA's Main Brief, PPL's proposed revisions to Tariff Rule 5A are designed to make the Company's customers liable for damages arising out of any interruption or variation in PPL's provision of electric service. See generally id. at 59-61. First, and as conceded by PPL, PUC precedent does not exist to support the Company's proposal. Id. at 60. Next, PPL's alleged internal procedure related to protective devices on the customer's side of the meter is an insufficient basis to codify what amounts to a legal limitation on PPL's liability for damages caused by service interruptions. Id. Finally, PPL's proposed Tariff Rule 5A appears to limit the Company's duty furnish "adequate, efficient, safe and reasonable service and facilities," as mandated by the Public Utility Code. Id.

Thus, PPL's proposed revisions to Tariff Rule 5A not only lack legal basis, but also appear to unlawfully limit the Company's duty to provide the quality of electric service required by the Public Utility Code. For these reasons, the Commission must reject the Company's unjust and unreasonable modifications to Tariff Rule 5A.

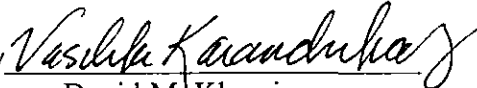
IV. CONCLUSION

WHEREFORE, PP&L Industrial Customer Alliance respectfully submits that the Pennsylvania Public Utility Commission should modify several of Administrative Law Judge Turner's recommendations set forth in her Recommended Decision regarding PPL Electric Utilities Corporation's proposed Supplement No. 38. Specifically, for the reasons set forth herein and in PPLICA's Main and Reply Briefs, the Commission should:

- Reject PPL's proposal to amortize and recover approximately \$15 million in deferred Hurricane Isabel costs;
- Reject PPL's proposal to continue ratepayer funding of the SEF via distribution rates;
- Adopt an ROE of 9.5% and an overall ROR of 7.85%;
- Reject PPL's TSC proposal and adopt PPLICA's alternative TSC proposal that presents a "middle ground" reflecting cost causation principles and accommodating concerns for rate stability and competition in a just and reasonable manner;
- Reject PPL's distribution revenue increase allocation proposal and adopt PPLICA's just and reasonable distribution revenue increase allocation proposal; and
- Reject PPL's unjust and unreasonable revisions to Tariff Rule 5A.

Respectfully submitted,

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Dated: November 12, 2004

CERTIFICATE OF SERVICE

I hereby certify that I am this day serving a true copy of the foregoing document upon the participants listed below in accordance with the requirements of 52 Pa. Code Section 1.54 (relating to service by a participant).

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Certificate of Service
Page 3
Docket No. R-00049255

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November 12, 2004

VIA HAND DELIVERY PRIOR TO 2:00 P.M.

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DOCUMENT

Re: Pennsylvania Public Utility Commission
v.
PPL Electric Utilities Corporation
Docket No. R-00049255

Dear Secretary McNulty:

Enclosed for filing, please find an original and nine (9) copies of the Office of Consumer Advocate's Exceptions, in the above-referenced case.

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

Sincerely,

Tanya J. McCloskey
Tanya J. McCloskey
Senior Assistant Consumer Advocate

Enclosures

- cc: All Parties of Record
- Honorable Allison Turner (VIA OVERNIGHT DELIVERY)
- Honorable Susan D. Colwell (VIA HAND DELIVERY)
- Honorable Ember S. Jandebour (VIA OVERNIGHT MAIL)
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission, et al

v.

PPL Electric Utilities Corporation

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:
:
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Docket No. R-00049255

OFFICE OF CONSUMER ADVOCATE'S
EXCEPTIONS

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I. INTRODUCTION

On October 22, 2004, the Office of Administrative Law Judge issued the Recommended Decision ("R.D.") of Administrative Law Judge ("ALJ") Turner in the above-captioned case. In her R.D., Judge Turner recommended that PPL Electric Utilities Corporation ("PPL" or "the Company") be permitted to increase its distribution operating revenues by \$130,111,983. R.D. at 182, Ordering ¶2 (Errata issued October 25, 2004). In addition, the ALJ recommended that PPL's proposal to collect \$57.2 million in increased transmission costs be approved. Id., Ordering ¶3.

Included as part of the ALJ's revenue requirement recommendation is a 10.25% return on equity. The ALJ also ruled on numerous rate base, revenue and expense adjustments proposed by the various parties to the proceeding. As to the allocation of the rate increase among the various customer classes, the ALJ recommended adoption of the Company's proposal, a proposal which the Office of Consumer Advocate ("OCA") also supported. In addition to seeking an increase in revenues, PPL proposed an unprecedented electric Distribution System Improvement Charge ("DSIC"). The ALJ properly rejected this proposal. R.D. at 32-47.

Overall, the OCA submits that the ALJ's Recommended Decision thoroughly analyzes the issues and reasonably resolves many of the difficult issues presented by this first major electric distribution rate case following the restructuring of the electric industry. Although many traditional base rate issues have been presented in this case, some of these issues must be viewed in a different light given the passage of the Electricity Generation Customer Choice and Competition Act ("Act") and the restructuring of the electric industry that has occurred since the passage of the Act in 1996. In two key areas affected by the Act and restructuring, the OCA differs with the ALJ's recommendation. Specifically, the OCA excepts to the ALJ's

recommendation that the Company be allowed a 10.25% return on equity and to the ALJ's recommendation that the Company be permitted to recover certain costs incurred during the rate cap period after the expiration of the rate cap.

As it concerns the return on equity, rather than reviewing the rates and rate of return requirements of a vertically integrated utility, the ALJ and the Commission are reviewing PPL's operations as a distribution-only electric utility in this case. Through the restructuring process, PPL has transferred its high-risk generation assets to affiliates and has been transformed from an integrated utility with a high degree of generation asset concentration to a low-risk delivery service company. Additionally, capital costs have declined substantially and recent changes in the federal tax code have substantially lowered the income tax rate on both capital gains and corporate dividends with the dividend tax reduction being particularly dramatic. While the ALJ recognized these factors and properly rejected the Company's excessive return on equity claim, the ALJ's recommendation still does not fully capture these factors due to the ALJ's use of a Discounted Cash Flow ("DCF") calculation that contains a flawed growth rate factor. R.D. at 117-122. When the growth rate factor is corrected in the analysis, the return on equity falls squarely within the range of the OCA's recommendation of a 9.5% return on equity. The OCA's recommended return on equity fully captures all of the relevant factors. As set forth in OCA Exception No. 4, the OCA urges the Commission to adopt the ALJ's reasoning, but to correct the flawed growth rate assumption to arrive at a return on equity that is fully representative of PPL's current business structure and risk profile, as well as the changes in the markets since PPL's last base rate case.

The ALJ also erred in failing to give full effect to the rate cap provisions of PPL's Restructuring Settlement, governed by Section 2804(4)(iii) of the Public Utility Code. As discussed in OCA Exception No. 2, PPL requested recovery of costs incurred in 2003, during the rate cap period, resulting from Hurricane Isabel. PPL had deferred these costs incurred during the rate cap for future recovery after the rate cap expired. Both the Commission and the Commonwealth Court have been clear that deferral of costs incurred during the rate cap period for recovery after the rate cap period is a *de facto* request for a rate cap exception. Petition of Metropolitan Edison Company and Pennsylvania Electric Company For Interim Relief Pursuant To Section F.2 Of Their Approved Restructuring Plan, Docket Nos. P-00001860 and P-00001861 (Reconsideration Order entered February 21, 2001) (Petition of Met-Ed and Penelec, Reconsideration Order entered February 21, 2001); ARIPPA v. Pennsylvania Public Utility Commission, 792 A.2d 636 (Pa. Commw. 2002) (ARIPPA). For recovery to be allowed, the request must meet the requirements for a rate cap exception under Section 2804(4)(iii). There is no exception under the rate caps for recovery of costs related to PPL's claims for storm damage from Hurricane Isabel and employee displacement costs from 2003.¹ Storm damage costs are the very type of operating costs encountered by an electric distribution company ("EDC") that an EDC agreed to bear under the Act and the Restructuring Settlements. The fact that the storm was "extraordinary" as PPL argued does not change this fundamental point. The same analysis applies to the employee displacement costs. In this instance, the Commission must look to the Act to determine the proper result. Otherwise, the rate cap provisions of the Act and the Restructuring Settlements would have no meaning. EDCs could simply defer all costs until their

¹ The ALJ disallowed the Company's claim for employee displacement costs on other grounds, but a key reason for rejecting this claim in this case, and in any other case where the Company might forward the claim, is that it violates the agreed upon rate cap.

first base rate case and evade the rate caps entirely. When the Act is reviewed, it is evident that no exceptions apply to PPL's claims and the claims must be denied.

The OCA submits that the Company has justified an increase in distribution revenues of \$115.2 million. The OCA's differences with the ALJ's recommendation are not many and will be discussed in detail below. The OCA will demonstrate the limited adjustments necessary to the ALJ's recommendation to produce rates that are just and reasonable for PPL customers.

II. RATE BASE

OCA Exception No. 1: The ALJ Erred In Recommending That The Commission Reject The OCA's Removal of the Company's Prepaid Postage Adjustment to Rate Base. (R.D. at 13-15; OCA M.B. at 19-20; OCA R.B. at 7-9.)

The ALJ agreed that inclusion of a separate prepaid postage expense claim in rate base where the postage expense is also captured in the Company's lead/lag study and becomes part of the cash working capital claim in rate base results in a double count for prepaid postage. R.D. at 15. The ALJ, however, recommended that the Commission deny the OCA's removal of the \$381,000 prepaid postage expense from rate base because the OCA did not cite any source that the Company has included the balance of prepaid postage in rate base to reflect the fact that it purchases postage in advance of using it to send bills. Id. The ALJ concluded that "[i]f the OCA's statement of the evidence were correct, she would agree with the OCA's analysis that allowing this claim would result in a double recovery, and reject the Company's rationale that it is actually covering two separate time periods." Id.

As explained in the OCA's Main Brief, the record evidence in this proceeding shows that the Company made two adjustments relating to prepaid postage. First, as presented on Attachment II-B-4, page 10 of the Company's filing, the Company has included 13.73 negative lag (or "lead") days for postage expense in the lead/lag study. The negative lag days calculated were based upon the date of the prepayment to the date the postage was used. This has the effect of reflecting the prepaid postage in the lead/lag study and thus in the cash working capital that is included in rate base and earns a return. The Company then makes an additional adjustment to rate base for prepaid postage by increasing rate base by \$381,000 for prepaid postage. Schedule C-4, page 3, line 15; see also PPL St. No. 5 at 6. As explained by OCA witness Morgan, by making this additional adjustment on Schedule C-4 to rate base, there is a

double count of prepaid postage because the lead/lag study already accounts for prepayments relating to postage on Attachment II B-4, page 10. OCA witness Morgan testified:

With respect to expenses in the cash working capital study, lead days represent prepayments, and the effect of applying lead days to expenses is to provide the amount of committed funds (or prepayments) on which a company is entitled to earn a return. Given that PPL has already included prepaid postage in the lead/lag study with lead days assigned, it would be inappropriate to also separately include prepaid postage in rate base because doing so would result in including the prepayment twice.

OCA St. No. 1 at 11-12. The Company's inclusion of a separate adjustment to rate base for prepaid postage results in a double-recovery.

The ALJ agreed with the OCA that a double count has occurred but rejected the OCA's removal of the Company's prepayment claim because the OCA has not shown that the Company has included prepaid postage in rate base to reflect the fact that the Company purchases postage in advance of using it to send bills. See R.D. at 15. Schedule C-4, page 3, line 15 shows this adjustment to rate base and PPL witness Kleha testified as to this adjustment. PPL St. No. 5 at 6. The Company included the prepaid postage adjustment in rate base to reflect the fact that the Company purchases postage in advance of using it to send bills. Company witness Kleha stated with respect the Schedule C-4 that the Company pays certain costs prior to the time such items are properly charged as an expense for ratemaking purposes. PPL St. No. 5 at 6.

As the OCA explained in its Main Brief, the OCA does not dispute that PPL has a prepaid postage balance; however, as explained above, the manner in which PPL has measured the postage lead for its lead/lag study fully accounts for this prepayment. OCA M.B. at 8. The record evidence supports the removal of \$361,000, after the Pennsylvania allocation factor is

applied to the Company's claim of \$381,000, from the Company's rate base claim as shown on
OCA Sch. LKM-7S.

III. EXPENSES

OCA Exception No. 2: The ALJ Erred In Determining That The Rate Cap Agreed To By PPL As Part Of The Company's Restructuring Settlement Did Not Bar Recovery Of The Hurricane Isabel And Employee Severance Claims. (R.D. at 47-62; OCA M.B. at 23-33; OCA R.B. at 12-17.)

A. Introduction.

PPL sought actual recovery of two expense items from 2003--a time period when the Company was under rate caps (pursuant to its Restructuring Settlement) that were governed by Section 2804(4)(iii) of the Public Utility Code. See 66 Pa.C.S. §2804(4)(iii). In its Restructuring Settlement, PPL agreed to cap its transmission and distribution rates until December 31, 2004 and only increase those rates if it satisfied the requirements of Section 2804(4)(iii), regarding exceptions to the rate caps and one other limited circumstance not relevant here.² The R.D. discusses Section 2804(4)(iii) in relation to PPL's claim for recovery of costs incurred in 2003 from Hurricane Isabel. R.D. at 51-57. Based on her interpretation of Section 2804(4)(iii), ALJ Turner determines that the rate caps do not bar PPL's claim for recovery of its Hurricane Isabel costs. Judge Turner also applies her reasoning to PPL's Employee Severance Expense claim from 2003. Although ALJ Turner disallows the Employee

² In PPL's Restructuring Settlement, PPL voluntarily agreed to extend the statutory rate cap period for transmission and distribution rates through December 31, 2004. PPL specifically agreed that the statutory rate cap under Section 2804(4) would be extended. The Restructuring Settlement provides:

The cap on PP&L's transmission and distribution charges, which otherwise would expire on June 30, 2001 under Section 2804(4) of the Electric Competition Act (66 Pa.C.S. §2804(4)), will be extended until December 31, 2004, provided, however, that PP&L may, if necessary, request recovery of additional nuclear decommissioning expense and such expense recovery will not be subject to any rate cap and will be treated as an exception to the rate cap under Section 2804(4)(iii)(F) of the Public Utility Code and such increases shall not reduce the shopping credits listed in Appendices A and B and such increases shall be allocated to the appropriate unbundled rate category in accordance with determinations of the Commission. 66 Pa.C.S. §2804(4)(iii)(F).

Severance Expense claim on other grounds, she finds that Section 2804(4)(iii) does not bar this claim. As explained below, however, the ALJ's determination is inconsistent with Commission and Pennsylvania Commonwealth Court rulings on this issue. PPL's agreed-upon rate caps do, in fact, bar recovery of PPL's Hurricane Isabel and AMR expense claims.³

B. Hurricane Isabel

1. Introduction

In addressing PPL's request for recovery of Hurricane Isabel costs, Judge Turner correctly focuses on Section 2804(4)(iii) as well as the Pennsylvania Commonwealth Court's decision in ARIPPA. R.D. at 47. The R.D. incorrectly determines, however, that PPL's claim in the instant proceeding differs from those in ARIPPA and that Section 2804(4)(iii) is not relevant. R.D. at 51. As a result of this incorrect determination, PPL's claim for recovery of Hurricane Isabel costs is accepted, while the applicability of Section 2804(4)(iii) is disregarded and the holding in ARIPPA is misinterpreted. As explained below, the Commission's decision in Petition of Met-Ed and Penelec, Reconsideration Order entered February 21, 2001 and the Commonwealth Court's decision on the Commission's subsequent Final Order in ARIPPA are directly on point. Here, just as was proposed by the former GPU companies in Petition of Met-Ed and Penelec, Reconsideration Order entered February 21, 2001 PPL, has deferred costs incurred during the rate cap period for recovery after the rate cap period. The Commission has been clear that deferral of costs and later recovery after the rate cap period is, in fact, a request to exceed the rate cap. Petition of Met-Ed and Penelec, Reconsideration Order of February 21, 2001, p. 4-5. Therefore, analysis of PPL's claim must involve consideration of whether the

³ PPL incurred its Hurricane Isabel costs in 2003 and deferred these costs for accounting and financial reporting purposes so that the Company could seek future recovery. Similarly, PPL offered enhanced severance benefits to 94 employees "in order to capture the payroll and benefits savings of AMR" and recorded an \$8.8 million charge in September of 2003.

requirements for exception to the rate cap have been met. When analyzed under Section 2804(4)(iii), it is clear that PPL's request to recover Hurricane Isabel costs does not meet any of the requirements for an exception to the rate cap. As such, this claim must be denied.

2. The Public Utility Code As Well As Commission And Commonwealth Court Precedent Mandate That PPL's Hurricane Isabel Expense Claim Be Rejected.

The Commission was confronted with the deferral/rate cap exception issue when the former GPU Energy Companies (Metropolitan Edison Company and Pennsylvania Electric Company) requested permission to defer purchased power costs incurred to meet their provider of last resort obligation during the rate cap period for recovery after the end of the rate cap. See Petition of Met-Ed and Penelec, Reconsideration Order of February 21, 2001, p. 4-5. In an Order on Reconsideration in the initial stages of the proceeding, the Commission made the point as follows:

[T]he Commission recognized that by seeking approval to recover amounts above the existing rate caps for service rendered now through a mechanism designed to defer collection of those amounts until a later time, the Companies are effectively seeking permission to exceed the rate caps.

We continue to believe that it is necessary for the Companies to meet the requirements of the Act before they can be permitted to recover, in whatever form, rates in excess of the rate caps.

Therefore, we will clarify that the Companies must meet the requirements of the Act regarding rate cap exceptions for either present or deferred recovery of rates which exceed the rate cap for service rendered during the rate cap period.

Petition of Met-Ed and Penelec, Reconsideration Order of February 21, 2001, p. 4-5 (emphasis added). PPL's attempt to recover its deferred costs is identical to the attempt made by the GPU companies. PPL deferred costs above its rate caps in 2003 for collection after the rate cap period. As the Commission made clear, such an end-run around the rate caps is not allowed and resolutions of such deferrals will be considered based on application of Section 2804(4)(iii).

Subsequent to this February 21, 2001 Order, the Commission entered an Order on June 20, 2001 in the same proceeding accepting a Settlement agreed to by the parties. The Order was appealed to the Pennsylvania Commonwealth Court. In the appeal of the Commission's Order, the Commonwealth Court confirmed that a deferral of costs during the rate cap period for later recovery must meet the standards for a rate cap exception. ARIPPA, 792 A.2d at 663-666. In ARIPPA, among the issues being considered by the Court was the Deferral Tracking Mechanism ("DTM") proposed by the GPU Energy Companies that the Commission had previously found to be a request for a rate cap exception in its February 21, 2001 Reconsideration Order. The Court first explained that the DTM, or deferral mechanism, would permit the GPU Energy Companies to defer for accounting and regulatory purposes the net difference between their retail charges for PLR generation service and their actual market cost of supply. ARIPPA, *Id.* at 649, fn. 23. In discussing the challenge to the DTM by the parties, the Court captured the essence of the deferral mechanism as follows:

Intervenors contend that the Commission erred in granting a rate increase above the rate caps in the guise of the DTM because it did not meet the requirements for relief from the rate cap limitations under 66 Pa.C.S. §2804(4)(iii)(D)

ARIPPA, *Id.* at 663. The Court then analyzed whether the GPU Energy Companies had met the requirements for a rate cap exception under Section 2804(4)(iii)(D) relating to the costs of purchased power outside of the control of the utility. The Court concluded that GPU had not met the requirements for a rate cap exception and thus, it was "plainly erroneous" for the Commission to allow deferral and future recovery of costs above the rate caps. ARIPPA, *Id.* at 666. As the Court had previously noted, this increase came in the guise of a deferral. ARIPPA, *Id.* at 663. PPL's claim for recovery of its Hurricane Isabel costs—incurred during the rate cap period and deferred for recovery in a later period—must fail for the exact same reasons.

As previously set forth, the Hurricane Isabel costs were incurred during 2003, prior to the expiration on December 31, 2004 of the transmission and distribution rate caps agreed to by PPL in the Company's Restructuring Settlement at Docket No. R-00973954. OCA St. 2 at 11. Simply deferring these costs and then seeking to recover them *after* the expiration of the rate caps would defeat the very purpose of the rate caps. To allow recovery of these costs would constitute a *de facto* rate cap exception in violation of the Act and PPL Electric's Restructuring Settlement. Id. 66 Pa.C.S. §2804(4). See, ARIPPA and Petition of Met-Ed and Penelec, Reconsideration Order of February 21, 2001.

A review of those exceptions reveals that there is no exception to the rate cap for storm damage.⁴ 66 Pa.C.S. §2804(4)(iii). The storm damage costs that PPL has deferred and now seeks to recover in the instant proceeding are the types of costs encountered by an EDC in operating and maintaining its distribution system over the course of many years. Therefore, these are the very types of costs that the EDC was at risk for under the Act and that PPL is at risk for under its Restructuring Settlement. The fact that the storm was significant or "extraordinary"—as PPL argues—does not change this fundamental point. Through the rate cap, operating risks, including risks of events like storms, were assumed by the Company, with only limited specified exceptions. PPL's claim does not meet any of the specified exceptions in either the Act or the Restructuring Settlement.

During the rate cap period, PPL explicitly assumed the risk of all operating costs, but for the exceptions enumerated in the statute. Under the Restructuring Settlement, the Company also retained the ability to keep any excess profits it could achieve during this period. See Application of Pennsylvania Power & Light Company, Docket No. R-00973954, (August

⁴ PPL refers to Hurricane Isabel as a "storm" and the resulting damage as "storm damage". See PPL M.B. at 30.

12, 1998) at paragraph B.5. In other words, under the Restructuring Settlement, PPL bore the risks, but could also retain the rewards. Allowing PPL to recover the costs associated with Hurricane Isabel would retroactively shift the risks that PPL assumed under its Restructuring Settlement onto ratepayers.

Based on the above, the OCA submits that ALJ Turner's determination should be rejected. Section 2804(4)(iii) and Commission, as well as Commonwealth Court, precedent dictate that PPL should not be allowed to recover Hurricane Isabel costs.

3. PPL's Rate Cap Period Is The Only Relevant Period To Consider When Analyzing The Hurricane Isabel Expense Claim.

In the R.D., based on arguments advanced by PPL, the ALJ concludes that prospective recovery of Hurricane Isabel costs is consistent with basic ratemaking procedures that allow amortization of historic costs. R.D. at 52. The ALJ relies on PPL's argument that it will be recovering these items in prospective rates under traditional ratemaking principles. PPL M.B. at 32-37. PPL tries to argue that since only its prospective revenue requirement will change as a result of the amortization of this extraordinary expense, there is no rate cap exception. PPL relies primarily on the principles of retroactive ratemaking.⁵ However, the Company's reliance on the principles of retroactive ratemaking reveals the flaw in its own argument. PPL is seeking actual recovery of one particular expense, which has been singled out from the applicable rate cap period. The fact that PPL requests that these costs be recovered in prospective rates does nothing to change its request. The rate cap period is the sole period to consider and the Hurricane Isabel costs were incurred during that period. Consequently, deferral for later recovery of these costs should not be allowed.

⁵ The ALJ correctly rejected PPL's argument that the rate cap argument is lopsided because other historic or future test year costs are not contested. As the ALJ notes, historic expenses are used as projections in ratemaking. Here, however, the Company seeks actual dollar-for-dollar recovery of one of those expenses. R.D. at 51.

This proceeding represents the first case after the expiration of a rate cap. Therefore, this proceeding must be viewed somewhat differently on some issues to ensure that the law and the bargain reached in the restructuring settlements are upheld. The request for actual recovery of costs incurred during the rate cap period is just such an issue. If an EDC were simply able to defer costs for subsequent recovery until after the agreed-upon rate cap expired, the rate caps would be meaningless. It was surely not the General Assembly's intent to allow the rate caps to be so easily circumvented. As previously set forth by the OCA, allowing recovery beginning in 2005 is effectively the same as having allowed an exception to the rate cap to permit recovery in 2003 or 2004. OCA M.B. at 29-30. The Company's Hurricane Isabel claim does not constitute an appropriate exception to the rate cap under Section 2804(4)(iii). Therefore, the ALJ's award in favor of this claim should be rejected.⁶

C. Employee Severance Costs Resulting From Implementation Of The Automated Meter Reading Program.

At pages 58-62, the R.D. addresses PPL's claim for recovery of employee severance costs resulting from implementation of the Company's automated meter reading program. Specifically, PPL requested amortization of an \$8.8 million pension termination benefit charge (over a 5-year period) related to the estimated costs of enhanced benefits for 94 employees to be separated as part of the AMR project. OCA M.B. at 30. The ALJ correctly denied this claim because the Company has made no payment and may not have to make a payment in the future. Although the OCA agrees with the determination to reject this claim, another key reason for such rejection is applicability of Section 2804(4)(iii), as well as, ARIPPA. As with recovery of Hurricane Isabel costs, PPL's request for recovery of \$8.8 in AMR displacement costs also ignores the applicability of the Company's distribution rate cap. Similar

⁶ The ALJ did make a partial adjustment to the Company's claimed amortization. R.D. at 56-57. The OCA submits, however, that the entire amortization claim is improper and must be rejected.

to PPL's Hurricane Isabel expenses, its AMR displacement costs were an expense accrual prior to the expiration of PPL's distribution rate cap. The OCA's arguments in support of denying Hurricane Isabel cost recovery due to the existence of a PPL distribution rate cap are equally applicable in this context. This request constitutes a *de facto* exception to the Company's agreed-upon rate cap. See Petition of Met-Ed and Penelec, Reconsideration Order of February 21, 2001; ARIPPA. Therefore, a key rationale for denying this claim should be applicability of Section 2804(4)(iii) and the holding set forth in ARIPPA.

Furthermore, the Company's argument that the non-economic benefits it identifies should be recognized in determining whether the costs exceed the benefits of the AMR implementation is misplaced. These non-economic benefits are too speculative and may even accrue to other entities. See OCA R.B. at 16. Consequently, there are several reasons, including the rate cap violation, to reject PPL's employee severance claim⁷ and all of these reasons should be recognized.

D. Conclusion

For the reasons set forth above (and in the Main and Reply Briefs of the OCA at 23-33 and 12-17, respectively), the OCA submits that the ALJ's determination that Section 2804(4)(iii), Commission precedent and Commonwealth Court precedent would permit recovery of PPL's Hurricane Isabel and Employee Severance Expense claims should be rejected.

⁷ Denial of recovery of the pension termination benefit charge will have no effect on PPL's displaced employees since the termination benefits to those employees have already been assured and will be paid from the pension trust fund.

IV. TAXES

OCA Exception No. 3: The ALJ Erred In Recommending That The Company's 2001 Net Income Be Included In The Capital Stock Tax Calculation Because The Evidence Shows That The Company Owned Generation Assets During 2001. (R.D. at 88-94; OCA M.B. at 40-42; OCA R.B. at 18-20).

The ALJ recommended that PPL's capital stock tax be calculated using five years of data beginning with net income from 2001 and projected through 2005. R.D. at 91, 93. The ALJ rejected the Company's argument that the capital stock tax be calculated using net income for the most recent five years, 2000 through 2004. *Id.* at 92-93. The ALJ properly excluded 2000 net income from the capital stock tax calculation finding merit in the positions of OTS and the OCA that the Company owned generation derived income that year. *Id.* at 91. Although the OCA set forth evidence that the Company's 2001 net income also included income from generation operations, however, the ALJ included the Company's 2001 net income to calculate the Company's capital stock tax. The OCA submits that the ALJ erred in including the Company's 2001 net income. The Company's 2001 net income included income resulting from generation operations and, therefore, should not be included in the capital stock tax calculation.

The OCA recommended that the Commission exclude 2000 and 2001 net income from the capital stock tax calculation because results of generation operations were included in the net income amounts for these two years. As OCA witness Morgan explained:

when compared to other years, the net income for 2000 and 2001 were significantly higher. It is my understanding that those years were higher because they included the results of the electric generation operations, which are no longer part of the Company's business. Therefore, I have removed 2000 and 2001 from the capital stock tax calculation because it is inappropriate to include generation costs in the cost of providing electric distribution service. Although I removed 2000 and 2001, I have added a projection of 2005 net income to the net income portion of the formula. The addition of the 2005 net income recognizes that the

Company's net income will increase as a result of a rate increase that is granted.

OCA St. No. 1 at 15. Company witness Kleha did not take issue with Mr. Morgan's statement that the Company's 2001 net income included results of generation operations. In fact, the only argument set forth by the Company in testimony and briefs relating to the OCA's removal of 2000 and 2001 net income data from the capital stock tax calculation was that the capital stock tax should be calculated using the most recent 5 years of net income pursuant to state tax law regardless of change in operations. PPL St. 5-R at 15-16, 18-19; PPL M.B. at 57; PPL R.B. at 21. As explained by Mr. Morgan, through conversations he had with the Company, he understood the Company had remaining generation assets that were transferred during 2001. Tr. 483. No Company witness has disputed this point. Based on this, the OCA removed 2001 net income from the calculation of the capital stock tax claim.

The OCA submits that the Commission should adopt the OCA's adjustment to the Company's capital stock tax claim by removing the 2001 net income which includes results of generation operations and projecting net income through 2005. The ALJ correctly removed 2000 net income data from the Company's capital stock tax calculation, but should have also removed 2001 net income data because it also contained results of generation operations. Generation operations should not be included in the distribution rates of PPL and by including 2001 net income, the Commission would be setting rates based on generation. Therefore, the Commission should adopt the OCA's adjustment to the Company's claim for capital stock tax expense, which results in a reduction of \$2,517,000.⁸ OCA Sch. LKM-16S.

⁸ This amount is calculated using the 2005 Capital Stock Tax Rate of 5.99 mills, which was recommended by the ALJ. R.D. at 93. Additionally, in its Main Brief, the OCA recommended that the capital stock tax be removed from the gross-up factor claim of the Company, which the OCA claimed resulted in a reduction of \$471,000. OCA M.B. at 41. The ALJ did not accept this specific amount; however, the ALJ's gross-up in her Final Tables is correct in that it does not include the capital stock tax. See Table I(B).

V. RATE OF RETURN

OCA Exception No. 4: The ALJ Erred In Adopting The 10.25% DCF-Derived Return On Equity Of Department Of Defense Witness Kincel Without Correcting The Anomalous 5.5% Growth Rate Used To Support The DOD's DCF Result. (R.D. at 117-118; OCA M.B. at 76-79; OCA R.B. at 36-38).

A. Introduction.

In the R.D., the ALJ recommended that the Commission adopt a return on equity ("ROE") of 10.25% based upon the testimony of the Department of Defense ("DOD") rate of return witness, Mr. Kincel. R.D. at 122. The ALJ reasoned that the DOD's 10.25% ROE recommendation, derived from the DOD's DCF model, was in accord with Commission precedent, and that the other parties did not offer criticism of the methodology used by the DOD to develop that rate. Id.

While the OCA agrees with the ALJ that the use of the DCF model is in accord with Commission precedent, the OCA respectfully disagrees with the ALJ on recommending the ROE Mr. Kincel derived from his DCF model. As OCA rate of return witness Mr. Kahal pointed out, and as set forth fully in the OCA Main Brief, both Mr. Kincel and Company witness Moul utilize an excessive 5.5 % growth rate in their DCF models, based in part on incorrect data for one of their barometer group companies, PEPCO Holdings.

DOD witness Kincel's DCF results show a much lower ROE result when the correct data for PEPCO Holdings is used, and when the low end of Mr. Kincel's growth rate range is used to calculate his DCF result. As is explained below, using accurate growth rate data produces results from DOD witness Kincel's DCF analysis that fall squarely into the DCF range developed by OCA witness Kahal. The 9.50% ROE recommended by the OCA (the top of the OCA's recommended range) is accurate and is adequate to produce an overall fair rate of return

or the Company.

B. Uncontested Record Evidence Shows That The DOD And The Company Premise Their Dividend Growth Rate Recommendations On Erroneous Data.

Both PPL and the DOD employ an excessive DCF growth rate because their barometer group growth rate calculations mistakenly use an anomalous 16% growth rate for PEPCO Holdings. PPL employs this 16% figure to support the 5.5% growth rate it advances as a part of its 10.25% unadjusted DCF rate. PPL St. No. 9 at 36, 37; PPL St. No. 9-R at 17. The DOD employs the 16% growth rate in a like fashion to support its 4.58% to 5.5% growth rate range that it uses to support the upper-range of its DCF result. DOD Exh. KLK-6; DOD Exh. KLK-16; DOD Kinzel Dir. at 10, 16. The source of this data is the June 4, 2004 Value Line report for PEPCO Holdings. All of the rate of return experts in this proceeding referenced this Value Line report in testimony, and the DOD submitted the report itself as an Exhibit. DOD Exh. KLK-6; DOD Exh. KLK-16; OCA St. No. 3-S at 15; OTS St. No. 1-SR at 5-6; PPL St. No. 9-R at 17.

Both OCA witness Kahal and OTS witness Deardorff testified that the Value Line report relied upon by the DOD and the Company is anomalous because of PEPCO's merger with Conectiv in August 2002. OCA St. No. 3-S at 15; OTS St. No. 1-SR at 5-6. While Mr. Kahal and Mr. Deardorff note that the Annual Rates section of the June 4, 2004 Value Line report provides that the estimated 2001-2003 to 2007-2009 dividend growth is 16%, they also clearly explain why this number is anomalous. Id. They explain that the figure is incorrect because, owing to the merger, Value Line included no dividend for the year 2001, and it understated the dividend received by shareholders in 2002. Id. This has the impact of greatly skewing the PEPCO Holdings dividend growth result. Id. In fact, OTS witness Deardorff pointed out the severity of this data problem by showing that only two months prior, in March 2004, Value Line

forecasted 35% dividend growth for PEPCO Holdings. OTS St. No. 1-SR at 5-6. He testified that calculations based on Value Line's disproportionate dividend growth rates for PEPCO Holdings in these reports yield useless results. Id. Neither the Company nor the DOD challenged this particular criticism.

OCA witness Kahal clearly explained the data problem as follows:

Table 2 below presents the 2004 to 2008 (the midpoint of 2007-2009) dividend growth rates from Value Line for the proxy group companies.

| Table 2 | | | |
|---|----------------------|----------------------|-------------------------------|
| Value Line Dividend Growth Rates | | | |
| Company | 2004 Dividend | 2008 Dividend | Calculated Growth Rate |
| C.H. Energy | \$2.16 | \$2.16 | 0.0% |
| Consolidated Ed | 2.26 | 2.34 | 0.9 |
| Duquesne Light | 1.00 | 1.04 | 1.0 |
| Energy East | 1.04 | 1.20 | 3.6 |
| Northeast | 1.40 | 2.15 | 7.9 |
| NSTAR | 2.24 | 2.50 | 2.8 |
| PEPCO | 1.02 | 1.14 | 2.8 |
| UIL | 2.88 | 2.88 | 0.0 |
| Central Vt. | 0.92 | 1.08 | 4.1 |
| Green Mountain | 0.88 | 1.28 | 9.8 |
| Average | --- | --- | 3.3% |

Source: Value Line Investment Survey, June 4, 2004

The average is 3.3 percent, not 5.5 percent as Mr. Moul erroneously claims.

[Mr. Moul] cites a PEPCO growth rate of 16 percent, whereas the growth rate outlook for that company is about 3 percent. This appears to be a data problem associated with the merger between

PEPCO and Conectiv which closed in late in 2002, resulting in the formation of PEPCO Holdings. Value Line reports dividends of \$0 in 2001, \$0.42 in 2002 and \$1.00 in 2003. Since the growth rate that Mr. Moul reports is based on a "base year" of 2001 to 2003 average, the 16 percent figure is artificially inflated. The growth rate of 16 percent is incorrect because the 2001 and 2002 (pre merger) dividend figures are incorrect. Moreover, the dividend growth rate relevant to the investor is the 2004 going forward value, and that is 2.8 percent, not 16 percent. The corrected dividend growth rate data fully support my DCF estimate and contradict Mr. Moul's DCF growth rate assumption.

OCA St. No. 3-S at 14-15. While Mr. Kahal directs his criticism to the Company's presentation of this data, the error he identifies is equally present in Mr. Kincel's analysis since Mr. Kincel uses the same barometer group and the same 5.5% growth rate average for that barometer group.⁹

OTS rate of return witness Mr. Deardorff presented testimony similar to that of Mr. Kahal regarding this Value Line reporting problem. Mr. Deardorff characterized this data problem as a "perversion in Value Line's calculations of forecasted dividend growth." OTS St. No. 1-SR at 5. Mr. Deardorff testified:

Value Line forecasted a dividend growth rate of 35 percent for PEPCO in the March 5, 2004 issue but later lowered this forecast to 16 percent in the June 4, 2004 issue. The fact that these two forecasts are based on the same identical set of dividend cash flows makes either result questionable. Second, the calculations are based on an assumption that PEPCO only started paying dividends after the merger of PEPCO and Conectiv on August 1, 2002. Value Lines' growth rate calculations were based on PEPCO shareholders receiving dividends of \$0.00 in 2001, \$.42 in 2002, and \$1.00 in 2003. The actual records show that PEPCO shareholders received dividends on \$1.00 in 2001, and \$1.00 in 2003. Any calculations based on this clearly factual error will definitely yield useless results.

⁹ The DOD and the Company excluded UIL from their identical proxy groups. R.D. at 110. Excluding UIL from Table 2 above produces a Value Line dividend growth rate of 3.65%. This is well below the 5.5% supported by the DOD and the Company.

OTS St. No. 1-SR at 5-6 (emphasis added). Nevertheless, the Company and the DOD employ this anomalous data without question, and consequently, proffer similarly overstated and erroneous DCF results.

As Mr. Kahal indicated in his testimony, correcting this error produces a growth rate for PEPCO Holdings of 2.80%, and not 16% as Mr. Kincel and Mr. Moul contend. OCA St. No. 3-S at 14. OTS witness Deardorff also pointed out the fact that using a 16% growth rate for PEPCO Holdings is simply incorrect. OTS St. No. 1-SR at 5-6. Thus, the 5.5% average growth rate employed by Mr. Kincel in his DCF analysis is in error. Including the corrected 2.80% figure in Mr. Kincel's barometer group calculations produces an average growth rate of 3.85%, for a total DCF-derived ROE under Mr. Kincel's analysis of 8.61%. DOD Exh. KLK-6 (3.85% growth rate + 4.76% dividend yield). If the Commission were to simply use the low end of Mr. Kincel's growth rate range, his average growth rate would be 4.58%, and his total DCF-derived ROE would be 9.34%. DOD Exh. KLK-6 (4.58% growth rate + 4.76% dividend yield). All these results are in accord with the 3.5% to 4.5% growth rate range used by OCA witness Kahal, and his overall DCF range of 8.50% to 9.50%. OCA St. No. 3 at 29,30.

The Commission cannot use the 5.5% growth rate factor to support a 10.25% ROE because the record contains uncontested evidence showing that both the DOD and the Company employed this same anomalous growth factor data which overstates the DCF result. When corrected, Mr. Kincel's analysis produces a DCF-derived ROE that is fully supportive of the 9.50% ROE recommended by the OCA.

C. The Commission Should Adopt The OCA's 9.50% Recommended Return On Equity Because That Return Is Based On Accurate Data And Will Provide The Company With A Fair Rate Of Return On Equity.

Using correct PEPCO Holdings dividend growth forecasts (and other accurate data), Mr. Kahal developed a dividend growth rate range of 3.5% to 4.5%, and ultimately recommended the high end of that range as a part of his 9.50% recommended ROE. OCA St. No. 3 at 28-30 (5.0% dividend yield + 4.50% growth rate). In support of his 4.50% growth rate Mr. Kahal testified:

I provide a listing of four well-known sources of five-year analysts' earnings projections on page 3 of Schedule MIK-4. Three of the four sources, First Call, Zacks and S&P, provide the averages of surveys of securities analysts, while the fourth, Value Line, is based on a single source. For the eight proxy companies, the four sources indicate projected growth ranging from 3.2 percent (First Call) to 3.6 percent (Zacks). However, the UIL growth rate values are unusually low, and excluding that one company (recall that Mr. Moul does so), the projected earnings growth rates increase to approximately 4.0 percent. If the Vermont companies are included, the Value Line growth rates would increase to about 4.3 percent.

...

Based on this evidence, I believe that a reasonable long-run growth rate expectation would be about 3.5 to 4.5 percent. In fact, given the published projections this growth rate range should be viewed as conservatively high.

...

I summarize my DCF analysis on page 1 of Schedule MIK-4. For my electric delivery service proxy group, the dividend yield for the six months ending June 2004 is 4.86% percent and is adjusted forward to 5.0 percent. Adding a DCF growth rate range of 3.5 to 4.5 percent produces an investor expected return of 8.5 to 9.5 percent, with a midpoint of 9.00 percent. Due to the recent upward movement in interest rates, which is not fully reflected in the recent six-month average, I recommend 9.5 percent, or the upper end of my range.

OCA St. No. 3 at 29-30. Thus, it is clear that Mr. Kahal's recommendation encompasses the high end of the range of properly conducted growth factor analyses. Mr. Kahal's

recommendation is also accurate regarding the growth rates of the other proxy group companies in this proceeding.

D. Conclusion.

The testimony and evidence demonstrate that both Mr. Moul's 5.5% dividend growth rate and Mr. Kincel's 5.5% dividend growth rates are overstated. In contrast, Mr. Kahal has developed a growth rate with a range of 3.5% to 4.5% based upon the objective criteria of his eight proxy companies. OCA St. No. 3 at 29. This comports closely with Mr. Deardorff's growth rates of 4.13% for his group of six barometer companies, and 4.03% for his group of nine barometer companies and with the low end of Mr. Kincel's range, 4.58%. OTS St. No.1, Exh. No 1-SR, Sch. 2 at 1-2. When corrected for the PEPCO Holdings growth rate anomaly, the DOD DCF-derived ROE supports the 9.50% ROE developed by OCA witness Kahal. The OCA requests that the Commission grant this Exception and find that a 9.50% return on equity is supported by the corrected DCF results of DOD witness Kincel, as well as the well-supported DCF recommendation of OCA witness Kahal. The OCA submits that a 9.50% return on equity will produce an overall fair rate of return.

VI. RATE STRUCTURE/TRANSMISSION SERVICE CHARGE

OCA Exception No. 5: The Transmission Service Charge Rate Contained In The Errata Must Be Corrected.

The Transmission Service Charge rate contained in Ordering Paragraph 3 of the ALJ's R.D, as modified by the Errata notice issued by the Commission on October 25, 2004, is incorrectly stated. The rate contained in the Errata notice, \$0.05439 per kWh, should be \$0.00564 per kWh. See, R.D. at 124. In her Recommended Decision, the ALJ adopted the Company's uniform, reconcilable rate proposal. R.D. at 139. The ALJ correctly identified the Company's Transmission Service Charge rate proposal as 0.564¢/kWh in her R.D., which when stated on a dollar basis is \$0.00564 per kWh. R.D. at 126. The OCA submits that the correct, uniform Transmission Service Charge proposed by the Company and adopted by the ALJ is 0.564 cents per kWh, or \$0.00564 per kWh. The Final Order should contain this correction.

VII. UNIVERSAL SERVICE

OCA Exception No. 6: The ALJ Erred In Finding That The Commission Lacked Jurisdiction Over PPL's Efforts In Its Operation HELP Program. (R.D. at 171-172; OCA M.B. at 168-171; OCA R.B. at 64).

At pages 171-172 of her R.D., the ALJ rejects the OCA's recommendation that the Company provide a plan to increase contributions to the Operation HELP program, PPL's Hardship Fund program. The ALJ reasons that the Commission does not have any jurisdiction over this program since it is funded by voluntary contributions from shareholders, ratepayers and employees. The OCA submits, however, that the ALJ has confused jurisdiction over contributions to the program with jurisdiction over PPL's efforts in operating the program. The Commission has jurisdiction over PPL and its efforts in operating this vital universal service program. PPL is required, by law, to have universal service programs that are available and adequately funded. 66 Pa.C.S. §2804(9). As PPL's own testimony recognizes, and as the Commission regulations regarding the components of each EDC's universal service plan provide, Operation HELP is a key component of the universal service programs for PPL. PPL St. 7 at 6 and 52 Pa. Code §54.74(b). The Commission has full authority over the operation of this program by PPL.

While the OCA agrees that the Commission cannot direct any specific level of contributions to the program, and the OCA has not made such a recommendation, the Commission can direct PPL, a regulated electric distribution company, to take specific actions directed toward improving and increasing contributions to this universal service program so that the program is available and adequately funded. In fact, the Commission has recognized these Hardship Funds as universal service programs and requires, by regulation, that a Hardship Fund be included in the EDC's universal service plan. 52 Pa. Code §54.74. These plans are then

approved by the Commission. See, e.g., PPL's Universal Service and Energy Conservation Plan Submission, Docket No. M-00031698 (Order entered June 13, 2003). In addition, the Commission requires EDCs to report the amount of ratepayer and shareholder contributions to these programs, as well as the benefits of the program. 52 Pa. Code § 54.75(2)(ii)(D)(I)(III) & (IV). See, e.g., Bureau of Consumer Services Report on 2003 Universal Service Programs & Collection Performance, pp. 55-57 (Hardship Fund Section). The OCA submits that it is clear that the Commission has jurisdiction and authority over the operation of the Hardship Fund program by PPL.

The OCA submits that it is necessary for the Commission to exercise its authority to ensure that all reasonable efforts are pursued to develop contributions to Operation HELP. As OCA witness Colton demonstrated, PPL's Operation HELP has declined in all of its major attributes since 2000. Operation HELP: 1) provides smaller grants, even though arrears are higher; 2) has fewer contributions, even though total number of customers has increased; 3) receives fewer investor-contributed dollars; 4) raises less total money from customers; and 5) raises less money on a dollars-per-customer basis. OCA St. 5-S at 13-14. Shareholder contributions have declined from \$655,643 in 2001 to \$438,138 in 2002. OCA St. 5 at 41. Ratepayer contributions have also declined from a peak of \$392,625 in 2001 to a level of \$378,640 in 2003. OCA St. 5 at 39. It is evident from the record that more is needed to ensure that Operation HELP remains a vital program within PPL's array of universal service programs.

OCA witness Colton recommended that the Commission direct PPL to develop a plan, with specific action steps, to ensure that Operation HELP is adequately funded. Mr. Colton provided numerous examples of approaches to fundraising utilized by other utilities for their Hardship Funds. Suggestions include more frequent requests of customers, enrolling customers

in an on-going contribution program rather than seeking a one-time contribution, adopting an on-line fuel fund contribution mechanism, approaching vendors for contributions, and encouraging greater shareholder contributions as well as using any increased shareholder commitment to issue a challenge in a fundraising campaign. OCA St. 5 at 42-43. These ideas, and more, can be employed to attempt to reverse the decline in PPL's Operation HELP contributions.

The OCA submits that it is well within the Commission's jurisdiction to direct PPL to develop a plan with the goal of increasing contributions to Operation HELP from both ratepayers and shareholders. Operation HELP is a vital universal service program and the Commission is obligated by statute to ensure that these programs are available and adequately funded. 66 Pa.C.S. §2804(9). The Commission requires Hardship Fund programs as part of an EDC's universal service plan and requires EDCs to report on these programs, including contribution levels and benefit levels. PPL's actions regarding the continued development of this program are well within the Commission's jurisdiction. The Commission should direct PPL to develop a plan to increase both shareholder and ratepayer contributions to Operation HELP.

OCA Exception No. 7: The ALJ Erred In Not Recognizing That The Universal Service Programs Benefit All Customers And That The Costs Of These Programs Should Be Allocated Across All Customer Classes.
(R.D. at 173-176; OCA M.B. at 174-186; OCA R.B. at 66-76).

In this proceeding, the OCA argued that the costs of PPL's universal service programs should be allocated to all customer classes in the cost of service study since the programs provide benefits to all customer classes.¹⁰ At page 176 of her R.D., the ALJ concludes that the OCA has not presented a sufficient basis to change the Commission's policy on this

¹⁰ In this case, a proper allocation of the universal service costs to all customer classes within the cost of service study would more accurately reflect each customer classes contribution to the system average rate of return. The ALJ adopted the allocation of any rate increase to the customer classes that was proposed by the Company and supported by the OCA. The OCA is not seeking to further increase any class's share of the rate increase. The allocation, however, is important in recognizing that the residential class is bearing more of its cost responsibility than PPL's cost of service study shows.

issue. The policy the ALJ refers to is the Commission's determination that the prior allocation of these costs to residential customers before restructuring would continue as rates were unbundled to avoid any cost shifting during this unbundling process. The OCA submits, however, that the concerns against changing cost allocations while rates are unbundled no longer serves as a bar to determining the proper allocation of these costs under the Act. In this case, the OCA submits that there has been sufficient evidence presented to demonstrate that PPL's universal service programs should be reflected as a cost to all customers as a matter of law and a matter of sound public policy.

In this case, the Commission is presented with the issue of the proper allocation of universal service costs following the restructuring of the electric utility industry. During restructuring, the Commission determined that there was a prohibition against cost shifting that precluded the Commission from changing the way in which the costs of universal service programs were allocated to the customer classes during the restructuring process. See, Re: Pennsylvania Power & Light Company, 89 Pa. PUC 587, 658 (1998). For most EDCs, universal service program costs had been allocated to the residential class in prior base rate proceedings as these programs were introduced and developed. The Act and the record here, however, provide ample reason for the Commission to now determine that all customer classes should share responsibility for the costs of universal service programs. The OCA submits that the record provides ample evidence that universal service programs are a public good by law, and that they benefit all customers. As such, the costs of these programs should be shared by all customer classes.

The Act specifically addressed universal service programs for low income customers and the importance of these programs in a restructured electric utility industry. In the Act, the General Assembly has declared these programs to be a public good and required that these programs be available and adequately funded. Specifically, Section 2802(17) reads:

(17) There are certain public purpose costs, including programs for low-income assistance, energy conservation and others, which have been implemented and supported by public utilities' bundled rates. The public purpose is to be promoted by continuing universal service and energy conservation policies, protections and services, and full recovery of such costs is to be permitted through a nonbypassable rate mechanism.

66 Pa.C.S. §2802(17). As OCA witness Colton explained, one well-accepted tenet of utility ratemaking is that certain expenses incurred by a public utility for public goods are spread over all customer classes so that each end-user makes a financial contribution to the utility's delivery of public goods. OCA St. 5 at 27-28.

The General Assembly also recognized this fact and made its intention clear that all customers make a financial contribution to support these universal service programs by requiring that the programs be adequately funded and that the costs of these programs be recovered through a non-bypassable recovery mechanism. 66 Pa.C.S. §2802(17) and §2804(9). As OCA witness Colton testified, the term "nonbypassable" incorporates the concept that all customers should help pay for universal service costs since the bypass problem is that some customers will either leave the system entirely and leave their costs behind, or that they will negotiate a discount off of their charges by threatening to leave the system. OCA St. 5 at 27. Indeed, the language of the Act links both adequate funding for the programs with the broad statement that these costs be funded in a nonbypassable manner. 66 Pa.C.S. §2804(9). The Act suggests, and requires, the broadest allocation of these costs.

Such an allocation as contemplated by the Act recognizes the wide and varied benefits of these programs. As the record demonstrates, the benefits of universal service programs are not limited to residential customers. OCA witness Colton provided extensive testimony of the benefits of the programs to all customer classes. For example, Mr. Colton testified to the direct relationship between electric affordability programs and economic benefits to local commercial and industrial customers. OCA St. 5 at 29. Mr. Colton stated:

- Turnover costs business money. We know that unaffordable home energy bills lead to the frequent mobility of households.
- Time missed due to family care provision costs businesses money. We know that unaffordable home energy leads to more frequent childhood illnesses.
- Time missed due to lack of employee productivity and employee illness costs businesses money. We know that the inability to stay warm due to unaffordable home energy bills leads to increased illnesses.

OCA St. 5 at 30. OCA witness Colton continued:

In sum, we know that increasing employee productivity directly contributes to the increased profitability of firms. We know that with low-wage employees, in particular, unaffordable home energy directly contributes to lowered productivity. Increased personal illness, increased employee turnover, and increased family care responsibilities are but three of the factors contributing to lower employee productivity. The provision of affordable energy through the Company's proposed universal service program positively affects each of these productivity factors.

Id. Small businesses, in particular, receive special benefits as a result of universal service programs. Mr. Colton explained:

[S]mall business fills a unique role in the Pennsylvania economy. Small business disproportionately offers employment opportunities to Pennsylvania residents who have limited employment skills. Small firms disproportionately pay wages that do not allow a household to economically exist without public assistance.

OCA St. 5 at 30. There is a reciprocal relationship between small businesses and low-wage employees. On the one hand, without small business offering low-wage employment, many of the persons who are employed in such establishments would not find job opportunities. On the other hand, without the low-wage employee, many of the small businesses that produce goods and services within Pennsylvania would not be able to economically survive. Id. at 30-31.

Energy assistance programs assist this low-wage employee in meeting all bills for the necessities of life.

Energy assistance programs are also a significant contributor to economic development. As OCA witness Colton testified, energy assistance programs contribute to freeing up income within the low-income population that helps drive additional job creation, income generation, and economic activity which benefits businesses, large and small. OCA St. 5 at 31. The energy assistance program allows the household to utilize dollars that would have been devoted to unaffordable energy bills for other household items. Based on his research and reports in other states, OCA witness Colton explained the particular impact within a service territory in a Report for Entergy Service Corporation:

While the discussion of the economic impacts of energy assistance looks at economic benefits on a statewide basis, in fact, the economic impacts provide particular advantage to low-income communities. Existing research indicates that low-income households tend to shop at local retail establishments. For food in particular, low-income households tend to shop at small, local food stores. Moreover, not only are low-income *households* more likely to shop locally, but the *businesses* serving low-income households are more likely to shop locally as well. It is clear, therefore, that not only will the provision of energy assistance provide income and employment to low-income households, but the earnings and employment that are delivered to such households will likely be spent, retained and recirculated within the low-income community as well.

OCA St. 5 at 31-32. (emphasis in original) See also, Roger Colton, The Economic Impacts of Home Energy Assistance: The Entergy States (Entergy Services Corp: Little Rock (AR))(August 2003).

Other benefits of the program that inure to all ratepayers include the increased efficiency of the Company's use of its own employees, particularly those that deal directly with credit and collection efforts. Employees that are not burdened with handling credit and collection matters can be redirected to other necessary activities that PPL needs to have done. OCA St. 5 at 33. These necessary jobs are not limited to credit and collection activities for residential customers. The necessary jobs can encompass a range of activities, thus improving the efficiencies of the Company to the benefit of all customer classes.

The benefits of universal service programs are wide and varied, direct and indirect. The programs have been designated a public good by the General Assembly, and fall within accepted definitions of public goods used in the regulatory arena. OCA St. 5-S at 17-18 (quoting from the definition of public good by the National Regulatory Research Institute).¹¹ The costs of these programs should be shared by all customer classes as the General Assembly intended to reflect the fact of these system-wide benefits.

The primary argument raised by the opponents to such a sharing of these costs is that the benefits are too indirect so cost causation principles do not support allocating universal service costs to any class other than the residential class. While this argument ignores the many

¹¹ ALJ Rainey in his Recommended Decision issued August 13, 2004 in the Investigation Into PGW's Credit and Collections Activities, Docket Nos. P-00042090, R-00049157, M-00021612, P-00032061, recognized the fact that universal service programs are a public good. ALJ Rainey, in addressing a proposal that universal service costs be borne solely by residential customers, stated: "Universal service programs are designed to fulfill the "public good" and therefore the costs associated with these programs should be shared by all customer classes." R.D. at 32. The Commission's Final Order determined that it would not address cost allocation. in that proceeding so the existing allocation to all customer classes set forth in PGW's restructuring proceeding was maintained. Investigation into Philadelphia Gas Works, slip op. at 23-24 (Order entered October 27, 2004).

benefits of these programs to all customers, the argument simply proves too much. OCA witness

Colton testified:

If we assume that only low-income customers benefit, and we follow the rule that costs in this case should be allocated only to those who directly benefit, we are brought to the conclusion that universal service costs should be directly assigned pro rata to customers who participate in the universal service programs. Clearly this would be an absurd result, and one that could not logically have been intended by the legislature. In addition, there is no more reason to allocate costs to non-low-income residential customers under this reasoning than there is to allocate them to non-residential customers.

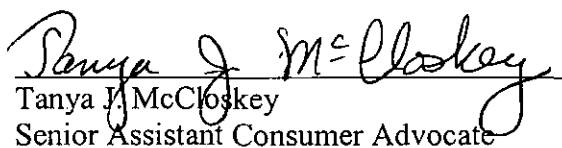
OCA St. 5 at 36. When taken to its logical conclusion, allocation based on strict cost causation principles would have only low-income customers support the cost of these programs – a result which is both untenable and absurd.

The General Assembly made it clear that universal service programs are a public good and are to be available and adequately funded in each EDC's service territory. The programs benefit all customer classes, and as a public good, the costs of the program should be shared by all customer classes. The Commission's prior decisions were grounded on the concern against impermissible cost shifting during the unbundling of rates process. Those concerns are no longer applicable to PPL. The Commission should now recognize the full range of benefits provided by these programs to all customer classes, and give meaning to the General Assembly's declaration that these programs are a public good. The Commission should ensure that all customer classes are allocated a share of the costs of these programs.

VIII. CONCLUSION

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief and Reply Brief, the OCA respectfully submits that the ALJ erred in her recommendation with respect to the above issues. The ALJ's recommendation on those issues should be rejected in favor of the positions advocated by the OCA in this proceeding as discussed above.

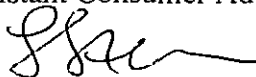
Respectfully Submitted,


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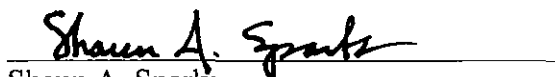
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CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission, et al
v.
PPL Electric Utilities Corporation
Docket No. R-00049255

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

Dated this 12th day of November, 2004.

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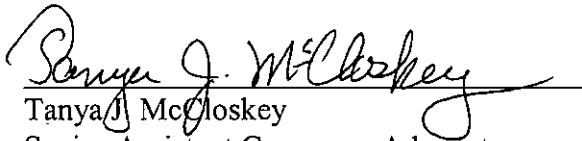
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