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ORIGINAL

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July 27, 2004

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SECRETARY'S BUREAU

James J. McNulty  
Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street, 2nd Floor North  
PO Box 3265  
Harrisburg, PA 17105-3265

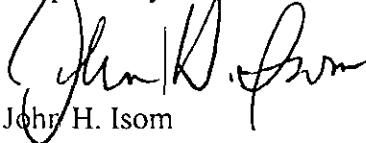
Re: **Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation**  
**Docket No. R-00049255**

Dear Secretary McNulty:

Enclosed, for filing, are four (4) copies of PPL Electric Utilities Corporation's Rebuttal Testimony in the above-referenced proceeding.

As indicated on the enclosed Certificate of Service, one copy is being served on each party. If any party wishes additional copies, they should contact the undersigned at the telephone numbers or addresses provided above.

Respectfully submitted,

  
John H. Isom

JHI/jl

Enclosure

c: Certificate of Service

# ORIGINAL

## BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

Docket No. R-00049255

### REBUTTAL TESTIMONY OF PPL ELECTRIC UTILITIES CORPORATION

Statement No. 2-R	Rebuttal Testimony of Joseph R. Schadt
Statement No. 3-R	Rebuttal Testimony of David R. Woodruff
Statement No. 4-R	Rebuttal Testimony of Douglas A. Krall
Statement No. 5-R	Rebuttal Testimony of Joseph M. Kleha
Statement No. 6-R	Rebuttal Testimony of Oliver G. Kasper
Statement No. 7-R	Rebuttal Testimony of Timothy R. Dahl
Statement No. 9-R	Rebuttal Testimony of Paul R. Moul
Statement No. 10-R	Rebuttal Testimony of Julie M. Cannell
Exhibit Future 1 (Revised)	

DOCUMENT

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**DOCUMENT**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-00049255**

**DOCKETED**  
JUL 28 2004

**PPL Electric Utilities Corporation**

**Statement No. 2-R**

**Direct Testimony of Joseph R. Schadt**

1 Q. Please state your name and business address.  
2 A. My name is Joseph R. Schadt. My business address is PPL Services  
3 Corporation, Two North Ninth Street, Allentown, Pennsylvania, 18101.  
4  
5 Q. Did you previously submit testimony in this proceeding on behalf of PPL Electric  
6 Utilities Corporation?  
7 A. Yes. I submitted my direct testimony (Statement No. 2) on March 29, 2004.  
8  
9 Q. What is the purpose of your rebuttal testimony?  
10 A. My rebuttal testimony responds to the assertions of witnesses on behalf of the  
11 various intervenors on the following topics:  
12 (I) the reduction in the claim for post retirement benefits other than  
13 pensions (responding to Messrs. Weakley and Morgan);  
14 (II) the reduction in the claim for pension expense (responding to Messrs.  
15 Weakley and Morgan);  
16 (III) the adjustments in the claim for Automated Meter Reading (AMR)  
17 displacement costs (responding to Messrs. Catlin, Weakley and  
18 Epstein);  
19 (IV) the elimination of the amortization claim for expiring amortization for the  
20 Power Management System Software and Deferred Taxes Related to  
21 the Cost of Removal Expense (responding to Messrs. Morgan and  
22 Weakley);  
23 (V) the adjustment to the claim for rate case communication costs  
24 (responding to Mr. Weakley);  
25 (VI) the reduction in the claim for Community Affairs (responding to Messrs.  
26 Morgan and Weakley);

- 1 (VII) the removal of On-Track arrearage forgiveness included in Uncollectible  
2 accounts expense presumed to also be included in On-Track Program  
3 costs (responding to Mr. Weakley);
- 4 (VIII) the normalization of FERC accounts 588 and 593 (responding to Mr.  
5 Weakley);
- 6 (IX) the adjustment to the environmental remediation expense claim  
7 (responding to Messrs. Morgan, Weakley, Prisco, McCormick and  
8 Epstein);
- 9 (X) the adjustment to increase late payment revenue which would lower the  
10 Company's revenue requirement (responding to Mr. Gruber);
- 11 (XI) the adjustment to the claim for injuries and damages based on the  
12 Company's historical amount for 2003 (responding to Mr. Prisco);
- 13 (XII) the adjustment for self funded health insurance (responding to Mr.  
14 Prisco), and
- 15 (XIII) the recommendation to align and incent a portion of executive  
16 compensation with "rate payers interest" and have executive  
17 compensation be indexed to reliability, community investment, and  
18 customer satisfaction (responding to Mr. Epstein).

19  
20 **I. Post Retirement Benefits Other than Pensions (SFAS No. 106)**

21 Q. Please describe the adjustments to the claim for post retirement benefits other  
22 than pensions proposed by Mr. Weakley and Mr. Morgan.

23 A. Mr. Weakley and Mr. Morgan recommend reducing the expense claim for post  
24 retirement benefits other than pensions. Mr. Weakley also recommends  
25 *reducing rate base*. PPL Electric's total cost of post retirement benefits other  
26 than pensions in this proceeding is \$13,916,000. The operating expense portion  
27 of the claim, \$9,672,000, is based on an estimate prepared by PPL's actuarial

1 consultant in October 2003. On March 30, 2004, the actuary updated the  
2 calculation of post retirement benefits other than pensions for 2004. The  
3 calculation indicated that 2004 costs would be less than the original estimate.  
4 The expense adjustments proposed by Mr. Weakley and Mr. Morgan are based  
5 on the March 2004 update of the calculation for 2004 submitted in response to  
6 Question 16 of Interrogatories of the Office of Consumer Advocate, Set X, dated  
7 May 20, 2004.

8  
9 Q. Do you agree with the adjustments proposed by Mr. Weakley and Mr. Morgan?

10 A. No, I do not agree. The March 2004 calculation assumed that union and non-  
11 union employees would be subject to the same cost sharing mechanism for  
12 retiree health care. In June 2004, PPL Corporation learned this assumption  
13 would violate the terms of its bargaining unit contract. As a result, in July 2004  
14 the actuary prepared a corrected calculation for 2004. Based on the corrected  
15 calculation for 2004, PPL Electric's cost for post retirement benefits other than  
16 pension is \$14,314,000, or \$398,000 more than the original estimate; the  
17 expense claim is \$9,948,000, or \$276,000 more than the original estimate. The  
18 letter from the actuary describing the error is attached as Exhibit JRS1 to my  
19 rebuttal testimony. Accordingly, the adjustments proposed by Mr. Weakley and  
20 Mr. Morgan should be rejected.

21  
22 Q. Has the Company previously informed the parties to this proceeding of these  
23 changes?

24 A. Yes. On July 15, 2004, supplemental responses to the following Interrogatories  
25 were filed:

- 26 • Question OTS-RE97 of Interrogatories of the Office of Trial Staff, Set 7,  
27 dated April 27, 2004.

- Question 15 of Interrogatories of the Office of Consumer Advocate, Set X, dated May 20, 2004.
- Question 16 of Interrogatories of the Office of Consumer Advocate, Set X, dated May 20, 2004.

## **II. Pension Expense**

Q. Mr. Morgan recommends an adjustment of \$489,000 to pension expense to reflect PPL Corporation's final 2004 actuarial report and an adjustment of \$36,000 to the Company's 2004 Supplemental Executive Retirement Plan (SERP) claim. The \$36,000 adjustment represents a 10% reduction in the SERP claim.

A. I agree with Mr. Morgan's recommended decrease of \$489,000 to PPL Electric's pension expense. I do not, however, agree with the \$36,000 reduction to the SERP claim, but would instead agree to a \$30,000 reduction in the SERP claim. At the time of budget preparation, PPL Corporation did not receive an actuarial report to support its SERP expense. Instead, PPL Corporation used the prior year costs as the basis for its budget and made an adjustment to reflect changes in discount rates between the two years. In March of 2004, the Company received the actuarial estimate for SERP expense that supports a \$30,000 reduction in the claimed SERP expense. Based on this information, PPL Electric would recommend a \$30,000 reduction in its SERP expense claim.

Q. Mr. Weakley recommends that the Commission reject PPL Electric's claim for pension expense. Mr. Weakley believes pension expense should be based on cash contributions to the pension fund, rather than the actual pension expense recorded in compliance with Statement of Financial Accounting Standards No. 87 Employers' Accounting for Pensions ("SFAS No. 87").

1 A. I disagree with Mr. Weakley's recommendation. Using SFAS No. 87 as the basis  
2 for the pension expense claim is consistent with the Commission's order in PPL  
3 Electric's last base rate proceeding at Docket No. R-00943271. SFAS No. 87  
4 requires accrual accounting for pensions and provides reasonably stable pension  
5 expense from year-to-year, resulting in more stable rates for the Company's  
6 customers. Rates based on cash contributions can result in dramatic  
7 fluctuations. Using pension costs calculated in accordance with SFAS No. 87  
8 provides consistency with revenues and other expenses included in PPL  
9 Electric's claim in this proceeding, which also are based on the accrual method of  
10 accounting. Using SFAS No. 87 for ratemaking also provides consistency in PPL  
11 Electric's accounting and reporting for pension expense from both generally  
12 accepted accounting principles (GAAP) and regulatory perspectives.

13  
14 **III. AMR Displacement Costs**

15 Q. Please describe the AMR Displacement Costs.

16 A. The cost of displacing employees as a result of the AMR Program was recorded  
17 as a pension special termination benefit charge for the benefits to be paid to  
18 separated employees, including enhanced early retirement benefits and one-time  
19 special pension separation allowances that will be paid from the PPL Retirement  
20 Plan pension trust. The pension special termination benefit charge of \$8.8  
21 million was actuarially calculated under the provisions of Statement of Financial  
22 Accounting Standards No. 88 "Employers' Accounting for Settlements and  
23 Curtailments of Defined Benefit Pension Plans and for Termination Benefits"  
24 ("SFAS No. 88"). The entire charge was recorded in the third quarter of 2003, at  
25 which time the final determination of terminations expected for the completion of  
26 the program was made.  
27

1 Q. Please describe the adjustments for AMR Displacement costs proposed by  
2 Mr. Catlin, Mr. Weakley, and Mr. Epstein.

3 A. Mr. Catlin, Mr. Weakley and Mr. Epstein recommend that recovery of the AMR  
4 *displacement costs not be allowed.*

5  
6 Q. What is the basis of Mr. Catlin's recommendation to not allow recovery of AMR  
7 displacement costs?

8 A. Mr. Catlin's testimony contains three reasons for his recommendation. First, Mr.  
9 *Catlin states that counsel advised him that allowing these costs to be amortized*  
10 *and recovered subsequent to the rate cap would constitute a de facto rate cap*  
11 *exception in violation of the Competition Act and PPL Electric's restructuring*  
12 *settlement. Second, he states that allowing PPL Electric to amortize the pension*  
13 *benefit termination charge in rates would result in ratepayers bearing costs which*  
14 *exceed the benefits of the AMR program. Third, he states that the expense*  
15 *accrual did not require a cash outlay by PPL and that PPL Electric may never be*  
16 *required to make a cash contribution to fund this expense.*

17 Q. Do you agree with Mr. Catlin's recommendation?

18 A. No, I do not. First, permitting recovery of these costs in prospective rates to be  
19 effective beginning January 1, 2005, does not change rates in effect through  
20 December 31, 2004, and, I am advised by counsel, is not a violation of the  
21 Competition Act and PPL Electric's restructuring settlement, as alleged by Mr.  
22 Catlin. The Competition Act and settlement do not address the setting of  
23 distribution rates beyond 2004. Second, Mr. Krall, in Statement No. 4-R, refutes  
24 Mr. Catlin's statement that allowing PPL Electric to amortize the pension benefit  
25 termination charge in rates would result in ratepayers bearing costs which exceed  
26 the benefits of the AMR program. Third, regarding Mr. Catlin's comment on cash  
27 outlay, cash funding of these costs, which have been or will be paid by the PPL

1 Retirement Plan, is subject to the rules of the Internal Revenue Service. Under  
2 these rules, cash contributions can be highly variable and can result in dramatic  
3 fluctuations. In my view, rate making for this pension special termination benefit  
4 charge should be consistent with that for SFAS No. 87.

5  
6 Q. What is the basis of Mr. Weakley's recommendation to not allow recovery of  
7 AMR displacement costs?

8 A. Mr. Weakley states that the claim will be paid by the pension trust and ratepayers  
9 already have paid these costs through past pension expenses included in rates.

10  
11 Q. Do you agree with Mr. Weakley's recommendation?

12 A. No, I do not. Mr. Weakley's statement that the claim will be paid by the pension  
13 trust and ratepayers have already paid these costs through past pension  
14 expenses included in rates is simply not true. Pension costs granted in the last  
15 base rate case were calculated on the basis of normal pension costs in  
16 accordance with SFAS 87. The AMR displacement costs are incremental costs  
17 not contemplated within the provisions of SFAS No. 87. These costs were  
18 actuarially determined under the provisions of SFAS No. 88, and must be  
19 recovered independently of normal SFAS 87 pension costs.

20  
21 Q. What is the basis of Mr. Epstein's recommendation to not allow recovery of AMR  
22 displacement costs?

23 A. Mr. Epstein asserts, among other things, that ratepayers should not pay PPL  
24 Electric to displace, reduce or terminate workers and should not have to fund  
25 Company layoffs and underwrite the costs of a program that will yield little net  
26 benefit to customers.

1 Q. Do you agree with Mr. Epstein's recommendation?

2 A. I do not agree. Mr. Epstein states conclusions without supporting evidence. I  
3 would like to point out that the Commission granted recovery of the costs of the  
4 Voluntary Early Retirement Program ("VERP") in PPL Electric's last base rate  
5 case at Docket No. R-00943271. In addition, the Company's claim for operation  
6 and maintenance expense in this proceeding includes the cost savings  
7 associated with the displaced employees. Schedule 5 of Exhibit Future 1 sets  
8 forth a decrease of \$5,950,000 in T&D-related wages, taxes and benefits for the  
9 future test year.

10  
11 **IV. Expiring Amortization**

12 Q. Mr. Morgan and Mr. Weakley each recommend eliminating the amortization claim  
13 for the Company's Power Management System Software of \$529,587. The basis  
14 for their recommendation is that 2004 is the last year of the five-year amortization  
15 period over which the Company expensed the costs of the software and because  
16 the rates from this proceeding go into effect on January 1, 2005, the cost will  
17 have been fully amortized.

18 Mr. Morgan also recommended eliminating the amortization of deferred taxes  
19 related to the cost of removal expense of \$177,000 because these costs will also  
20 be fully amortized as of the end of 2004.

21 A. The Company agrees with eliminating the amortization claim for the Power  
22 Management System Software since the amortization expires in 2004 and the  
23 Company has no plans to purchase any other capitalized software that would be  
24 amortized in 2005.

25 The Company does not agree with eliminating the amortization of deferred  
26 taxes related to the cost of removal expense of \$177,000. On July 15, 2004, the  
27 Company issued a supplemental response to Question 53 of Interrogatories of

1 the Office of Consumer Advocate, Set III, dated April 27, 2004. In the  
2 supplemental response, the Company corrected the \$177,000 debit amount to a  
3 credit amount and changed the remaining years of amortization from zero years  
4 to 1.6 years. The 1.6 years was calculated by dividing the December 31, 2003  
5 remaining balance to be amortized of \$284,000 by the 2004 amortization of  
6 \$177,000. *Because the amortization does not expire in 2004, the Company's*  
7 *claim of \$177,000 is correct and should be allowed.*

8  
9 **V. Rate Case Communications Costs**

10 Q. Please describe the adjustments for rate case communications costs proposed  
11 by Mr. Weakley.

12 A. Mr. Weakley recommends that the claim for rate case communications costs of  
13 \$130,000 be rejected.

14  
15 Q. What is the basis of the proposed adjustments?

16 A. Mr. Weakley believes the expense is a non-recurring expense.

17  
18 Q. Do you agree that the expense is non-recurring?

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

23 In preparation of the rate case filing, PPL Electric anticipated \$2,000,000 in  
24 rate case expenses associated with the case. The \$2,000,000 of anticipated  
25 expenses includes \$1,000,000 of budgeted expenses by PPL Services (including  
26 \$130,000 budgeted by External Affairs) and \$1,000,000 of expenses for legal  
27 fees, witnesses and other costs which were unbudgeted. The Company

1 proposed amortizing the total anticipated rate case expenses of \$2,000,000 over  
2 a two-year period, resulting in annual amortization of \$1,000,000. Because this  
3 annual amortization of \$1,000,000 equals the budgeted rate case expenses of  
4 \$1,000,000 for PPL Services, no additional adjustment is appropriate to rate case  
5 expenses or PPL Services expenses.  
6

#### 7 VI. Community Affairs

8 Q. Mr. Morgan and Mr. Weakley each recommended a reduction in the claim for  
9 Community Affairs expense from \$800,000 to \$500,000 because the budgeted  
10 amount should have been \$500,000 as per the Company's response to Question  
11 OTS-RE-86 of Interrogatories of the Office of Trial Staff, Set 7, dated April 27,  
12 2004.

13 A. The Company agrees with the proposed reduction of \$300,000, because the  
14 budgeted amount should have been \$500,000.  
15

#### 16 VII. On-Track Arrearage Forgiveness

17 Q. Mr. Weakley recommends the \$3.7 million for On-Track arrearage forgiveness,  
18 included in Account 908, as shown on Schedule B-4 of Exhibit Future 1, be  
19 removed from the Company's uncollectible accounts expense claim because it  
20 also is included in the Company's future test year claim of \$14.7 million for its  
21 On-Track Program costs. Mr. Weakley alleges that PPL Electric has double-  
22 counted the On-Track arrearage forgiveness in the future test year claim. Is this  
23 adjustment appropriate?

24 A. No, this adjustment is not appropriate. Mr. Weakley is correct that the \$3.7  
25 million for On-Track arrearage forgiveness is included in the \$14.7 million claim  
26 for On-Track Program costs, as shown on Schedule D-8, Adjustment for  
27 Increased Cost of Social Programs, of Exhibit Future 1. However, Mr. Weakley is

1 incorrect in asserting that PPL Electric has double-counted the On-Track  
2 arrearage forgiveness. Schedule D-8 compares the Company's total proposed  
3 social program costs of \$26,289,000 (which includes \$3.7 million for On-Track  
4 arrearage forgiveness) to the \$21,513,000 included in the 2004 budget for these  
5 programs (which also includes \$3.7 million for On-Track arrearage forgiveness in  
6 Account 908, Customer Assistance Expenses.) The net effect of the comparison  
7 for On-Track arrearage forgiveness is zero, since it is included in both the  
8 proposed costs and the budget. PPL Electric's response to Question OTS-RE-  
9 67 of Interrogatories of the Office of Trial Staff, Set 5, dated April 23, 2004  
10 identifies the accounts on Schedule B-4 that contain the cost of social programs.  
11 Account 908, Customer Assistance Expenses is included in that response.  
12 Account 904, Uncollectible accounts, was not included in the response and does  
13 not contain the \$3.7 million of On-Track arrearage forgiveness. In summary, the  
14 \$3.7 million for On-Track arrearage forgiveness has not been double-counted  
15 and accordingly, Mr. Weakley's recommendation should be rejected.

#### 16 17 **VIII. Normalization of FERC Accounts 588 and 593**

18 Q. Mr. Weakley recommends that the Company's claim for FERC Account 588 and  
19 FERC Account 593 be normalized by averaging the actual expenses incurred  
20 through 2001 and 2003, adjusted for inflation. Is this appropriate?

21 A. PPL Electric does not believe it is appropriate to select and normalize the claim  
22 for certain FERC accounts for two primary reasons. Mr. Weakley provided no  
23 justification for the use of a 3-year average that reduced expense by \$4,043,000.  
24 Given the nature of these accounts, a 5-year average may better capture the  
25 variability between years and therefore be more appropriate. The use of a 5-year  
26 average of these expenses would result in a \$1,725,000 adjustment for  
27 normalization of these two accounts.



1 Q. Please describe the adjustments for environmental remediation expense  
2 proposed by Mr. Morgan, Mr. Weakley, Mr. Prisco, Mr. McCormick and Mr.  
3 Epstein.

4 A. Mr. Morgan proposes using a three-year average to derive an allowable amount  
5 for environmental remediation expense. Mr. Weakley recommends that PPL  
6 Electric's total claim of \$3,556,000 be disallowed. Mr. Prisco (1) questions if  
7 ratepayers are responsible for remediation cost, (2) states that some of the  
8 properties may have been sold at a profit and the profit should be used to  
9 mitigate the cost of remediation, (3) states that it appears that the manufacturing  
10 of gas would be more similar to generating electricity than transporting an end-  
11 product, and (4) recommends amortizing the costs ultimately determined to be  
12 born by distribution customers over several years. Mr. McCormick states that the  
13 costs related to remediation at manufactured gas plants may be generation-  
14 related costs improperly included in the proposed distribution rates. Mr. Epstein  
15 states, among other things, that the projections are based on vague past  
16 references overly dependent on the random selection of a single site and far  
17 beyond what is necessary to complete the final phase of the PCB cleanup  
18 project.

19  
20 Q. What is the basis for their proposed adjustments?

21 A. The basis for their adjustments appears to be the view that environmental  
22 remediation costs are not the responsibility of the Company, and that actual  
23 expenditures do not support the claimed annual expense level of \$3,556,000.

24  
25 Q. What is your conclusion regarding the adjustments proposed by Messrs. Morgan,  
26 Weakley, Prisco, McCormick and Epstein?

1 A. These adjustments should be rejected. Before the advent of the interstate  
2 natural gas pipeline system in the mid-1900's, various utility companies, including  
3 predecessors to PPL Electric, supplied gas to its local customers by  
4 manufacturing the gas from coal and petroleum products. Once the natural gas  
5 pipeline transmission systems were developed, the utilities discontinued  
6 manufacturing gas, but continued to operate the local distribution systems to  
7 supply natural gas, rather than manufactured gas to its customers. Under state  
8 and federal laws, PPL Electric may be wholly or partially responsible for the  
9 remedial costs at these facilities. As a result, these assets remained with PPL  
10 Electric during its restructuring in 1998. Accordingly, Mr. Weakley's  
11 recommendation that the total amount of the remediation claim be disallowed  
12 should be rejected. Furthermore, because these facilities were used to serve gas  
13 distribution customers at that time, Mr. Prisco's questioning of whether  
14 ratepayers are responsible for remediation costs and his statement that it  
15 appears that the manufacturing of gas would be similar to generating electricity  
16 than transporting an end-product should be rejected. PPL Electric has not sold  
17 any of the facilities at a profit, consequently, Mr. Prisco's statement that some of  
18 these properties may have been sold at a profit and the profit be used to mitigate  
19 the cost of remediation is moot. For the reasons stated above, Mr. McCormick's  
20 statement that the costs related to remediation at manufactured gas plants may  
21 be generation-related costs improperly included in the proposed distribution rates  
22 should be rejected. Furthermore, Mr. Epstein questioned the future cost estimate  
23 that, in his opinion, was based upon a single site and was beyond what was  
24 necessary for the final phase of PCB cleanup. The single site Mr. Epstein was  
25 likely referring to in his statement was the former Sunbury Manufactured Gas  
26 Plant (MGP) site, which is not a PCB site. PPL Electric used the level of Sunbury  
27 MGP site costs, along with its past experience at other MGP sites, as its basis for

1 the proposed future annual remediation costs that it may incur to address the  
2 other 18 former MGP sites as discussed in PPL Electric's response to Question  
3 OTS-RE-149 of Interrogatories of the Office of Trial Staff, Set 20, dated  
4 June 8, 2004. Although the Company continues to believe that its claim is  
5 reasonable, it is difficult to project annual remediation costs with certainty. As a  
6 result, PPL Electric can accept the proposal of Mr. Morgan to use a three-year  
7 average to derive a reasonable amount for environmental remediation expense.  
8 The average expenditures for 2001-2003 for environmental remediation, as set  
9 forth on Schedule LKM-12 prepared by Mr. Morgan, are \$1,073,000. PPL Electric  
10 agrees to reduce its claim by \$2,483,000 for environmental remediation expense  
11 to \$1,073,000.

#### 12 13 X. Late Payment Revenue

14 Q. Have you reviewed Mr. Gruber's testimony regarding late payment revenue?

15 A. Yes, I have. Mr. Gruber recommends an increase in late payment revenue,  
16 which would lower the Company's revenue requirement. In Mr. Gruber's  
17 testimony, he states that the Company should not have rounded its five-year  
18 average late payment revenue calculation from \$6,336,000 to the claimed  
19 amount of \$6,000,000. Additionally, Mr. Gruber also states that the Company's  
20 five-year estimation methodology is not appropriate in calculating the rate case  
21 claim for late payment revenues. Mr. Gruber proposes using a three-year  
22 historical average of the percentage of overall revenue represented by late  
23 payment revenue, which would increase late payment pro forma revenue at  
24 present rates to \$7,090,000.

25 Q. Do you agree with Mr. Gruber's proposal?

26 A. No. The Company believes that using a five-year average of late payment  
27 revenue is appropriate and the methodology is consistent with rate case claims in

1 previous Company proceedings approved by the PUC. By using the actual late  
2 payment fee dollars over the last five years, instead of a percentage of late  
3 payment fee revenue over the total revenues, the Company has more accurately  
4 estimated the actual dollars forecast for the 2004 test year. The Company's use  
5 of an average of the actual billed dollars eliminates any material swings in billed  
6 revenues from year-to-year. However, the Company does agree with Mr. Gruber  
7 that rounding the average amount from \$6,336,000 to \$6,000,000 was not  
8 appropriate and believes that the rate case claim for late payment fees should be  
9 adjusted to the five-year average calculated amount of \$6,336,000.

#### 11 XI. Injuries and Damages

12 Q. Please describe the adjustments for Injuries and Damages proposed Mr. Prisco.

13 A. Mr. Prisco's testimony recommends the claim for injuries and damages be  
14 reduced by \$368,000 and refers to DOD Exhibit TJP-7. DOD Exhibit TJP-7 sets  
15 forth the adjustment as \$348,000.

16  
17 Q. What is the basis of the proposed adjustment?

18 A. Mr. Prisco believes that it is more appropriate to base the claim on the historical  
19 amount for 2003 (\$1,169,000) and not on speculation, and states that the  
20 Company will have fewer employees, which should reduce the cost from the  
21 previous year.

22  
23 Q. Do you agree with the proposed adjustment?

24 A. No, I do not agree. First, for the reasons referenced earlier in my testimony, the  
25 Company does not believe it is appropriate to select and normalize the claim for  
26 individual FERC accounts. Second, Mr. Prisco ignores the actual cost for 2001  
27 and 2002 which were \$1,374,198 and \$1,325,470, respectively, and focuses on

1 the 2003 amount, which was abnormally low. Accordingly, the proposed  
2 adjustment should be rejected.

## 3 4 XII. Self-Funded Health Insurance

5 Q. Please describe the adjustments for self-funded health insurance proposed by  
6 Mr. Prisco.

7 A. Mr. Prisco's testimony states that the self-funded insurance programs have been  
8 accumulating a large reserve over the past few years and recommends that  
9 \$3,000,000 of the \$3,573,000 liability balance should be returned to ratepayers  
10 and amortized over a three-year period, reducing the claim by \$1,000,000, as set  
11 forth in DOD/FEA Exhibit TJP-8.

12  
13 Q. Do you agree with the proposed adjustment?

14 A. No, I do not agree. Mr. Prisco is incorrect in his belief that the liability balance is  
15 too large. The liability balance at the end of 2003 also is \$3,573,000. As a result  
16 of the normal processing of medical claims, there is a delay or lag in the timing  
17 from when an employee receives medical care under an employer-sponsored  
18 plan, to the time the costs for those services are submitted by the health care  
19 provider to the insurance carrier, and ultimately to the employer for payment.  
20 Generally accepted accounting principles in the United States require the accrual  
21 of this estimated delay/lag, which is referred to as a medical claims Incurred But  
22 Not Reported (IBNR) liability. Standard practice is to reserve for between 60 and  
23 90 days of claims lag. PPL Electric's medical liability of \$3,573,000 includes an  
24 IBNR reserve of \$2.9 million based on a conservative 60-day assumed claims  
25 lag. The remaining amount of approximately \$673,000 represents known 2003  
26 claims paid in 2004.

1 More importantly, the \$3.6 million identified by Mr. Prisco is not even part of  
2 the Company's claim for health insurance. The claim for self-funded health  
3 insurance programs is \$18,838,000 which does not include the \$3.6 million  
4 referenced by Mr. Prisco. Actual claims charged against the liability were  
5 \$16,968,800 in 2003, \$19,540,000 in 2002 and \$17,903,200 in 2001 as set forth  
6 in the response to Question 31 of Interrogatories of the Office of Consumer  
7 Advocate, Set III, dated April 27,2004. The issue is the reasonableness of the  
8 claim of \$18,838,000, which is supported by historical experience and the trend  
9 in health care inflation.

### 10 11 **XIII. Executive Compensation**

12 Q. Mr. Epstein stated that PPL Electric should align and incent a portion of  
13 executive compensation with "rate payers interest" and that the percent of  
14 executive compensation allocated to PPL Electric should be indexed to reliability,  
15 community investment, and customer satisfaction. The index, established by the  
16 Corporate Governance Committee of the Board of Director's of PPL Corporation  
17 and the PUC Law Bureau, would be monitored by the Commission's Bureau of  
18 Consumer Services. As these categories increase or decrease, so would the PPL  
19 Electric portion of the executives' compensation contributions. The PUC also  
20 would be accorded non-voting Board monitor status on the Corporate  
21 Governance Committee.

22 Or, as Mr. Epstein stated, PPL Corporation ("PPL") could elect to eliminate  
23 corporate bonuses and incentives received from hostage PPL Electric  
24 ratepayers.

25 Do you agree with Mr. Epstein's statements?

26 A. No, I do not. In addressing the ideas that a portion of executive compensation  
27 allocated to PPL Electric should be based on "ratepayers interest" and indexed

1 based on reliability, community investment, and customer satisfaction, I have  
2 several comments. First, only a portion of PPL Corporation's executive  
3 compensation is allocated to PPL Electric because PPL Corporation executives  
4 oversee the entire corporation, including the delivery, supply, and international  
5 segments. Additionally, PPL Electric's allocation percentage has decreased from  
6 36.37% in 2002 to 26.49% in 2003 to 26.28% for the 2004 test year.

7 Over the years, PPL Electric has consistently won awards for customer  
8 satisfaction and community involvement. In five of the last six years, JD Power  
9 and Associates awarded the Company five first place East Region Residential  
10 Customer Satisfaction Awards. In four of the last five years of available results,  
11 JD Power and Associates awarded the Company four first place East Region  
12 Midsize Business Customer Satisfaction Awards. In addition, in the last two  
13 years, the American Customer Satisfaction Index (ACSI) rated the combination of  
14 PPL Electric and PPL Gas Utilities number one in a customer satisfaction survey  
15 of the 30 largest utilities in the nation. These awards certainly show that PPL  
16 Electric is highly regarded in customer satisfaction and community involvement  
17 and that executive salaries currently are appropriate based on the criteria  
18 suggested by Mr. Epstein.

19 In addressing Mr. Epstein's alternative of having PPL elect to eliminate  
20 corporate bonuses and incentives received from hostage PPL Electric  
21 ratepayers, I disagree. Incentives are a strong tool used to motivate executives  
22 and maintain corporate talent and expertise. To eliminate such incentives could  
23 cause a general decline in productivity and the Company may risk losing key  
24 executives on its management team.

25  
26 Q. Mr. Schadt, are you proposing any other adjustments than those previously  
27 mentioned?

1 A. Yes. I am also proposing an adjustment to the amortization of the Hurricane  
2 Isabel regulatory asset. This adjustment is based on a change in the regulatory  
3 asset balance as of 6/30/2004. The changes are a refinement to PPL's cost to  
4 restore service to customers after the storm. The total change to the regulatory  
5 asset was \$136,000, which decreases the annual amortization by \$27,000.

6  
7 Q. Mr. Schadt, are there any documents that summarize PPL Electric's witnesses'  
8 proposed adjustments and the impact to PPL Electric's rate request?

9 A. Yes. PPL Electric is filing Exhibit Future 1 (Revised), that reflects the changes  
10 described in this testimony and the testimonies of Mr. Kleha and Mr. Krall.

11

12 Q. Does that conclude your rebuttal testimony?

13 A. Yes.



June 21, 2004

Mr. Don Sparaco  
Director, Compensation & Benefits  
PPL Corporation  
2 North 9th Street  
Allentown, PA 18101-1139

Mr. T. W. Hatten  
Director of Investments and Pensions  
PPL Corporation  
2 North 9<sup>th</sup> Street  
Allentown, PA 18101 - 1139

Dear Don and Sunny:

**PPL POSTRETIREMENT MEDICAL PROGRAM  
2004 FAS 106 RESULTS**

The purpose of this letter is to review the following:

- Our understanding of the underlying methodology used to develop retiree medical contributions for retirees at PPL Corporation
- 2004 FAS 106 results, before reflecting the effects of Medicare Part D
- A preliminary discussion of 2004 accounting options that PPL can consider for reflecting the effects of Medicare Part D

**PPL RETIREE COST SHARING**

During 2002 to 2003, PPL and Towers Perrin discussed PPL's practice for developing retiree contributions in comparison to the assumed methodology in the FAS 106 valuation. The result of these conversations was that retiree contributions effective as of 7/1/2003 used an average of the previous two years' actual cost (claims plus expenses divided by adult plan participants) compared to the current year's DDB cap (the "two-year average" methodology). This methodology was reflected in the final 2003 FAS 106 results.

PPL, seeking to adopt a current year cap approach starting in 2004, opted to use a four-year transition approach for all retirees (union and management) to gradually reduce the "hidden subsidy" under the two-year average methodology. The methodology that PPL intended to use on a going forward basis was to use the prior year's actual cost projected with trend to the contribution period compared to the current year's DDB cap (the "projected" methodology). The hidden subsidy is, therefore, the difference between

the two years of lagging health care costs and the trended health care costs; this hidden subsidy was projected to be eliminated by the 7/1/2007 to 7/1/2008 contribution year.

Late in 2003, PPL released a letter to retirees and employees in order to communicate this projected method of developing retiree contributions. With this retiree communication, this methodology was considered to be the substantive plan effective for the 2004 FAS 106 valuation.

During 2004, an inquiry was made by a union representative challenging the new methodology. PPL researched the labor negotiation history and found an agreement from 1991, the time of retiree cap inception, stating the methodology the company would use in determining union retiree contributions.

For 2004, therefore, the revised substantive plan is as follows:

- For management retirees, the projected methodology with the four-year transition will continue. Retiree contributions will be determined on a calendar year basis going forward instead of each July 1. These costs will be based on non-union experience only.
- For union retirees, the retiree contributions will be determined on July 1 each year based on the excess of the prior calendar year's actual costs (claims plus expenses divided by adult plan participants) over the DDB cap. The costs will be based on experience from both union and non-union retirees.

#### **2004 FAS 106 RESULTS (PRIOR TO REFLECTING MEDICARE PART D)**

The following chart illustrates the change in 2004 FAS 106 obligations and expense for the current substantive plan. A detailed exhibit is enclosed as an attachment. Please note that these results do not reflect any effects from Medicare Part D.

Scenario (\$ millions)	APBO	Service Cost	FAS 106 Expense	Change
Two-year Average Methodology	\$499	\$6.7	\$47	--
Projected Methodology (applied to all capped retirees, previously communicated)	\$415	\$5.0	\$28	(\$19)
2004 Substantive Plan	\$451	\$5.7	\$36	\$8

**2004 FAS 106 RESULTS (ACCOUNTING OPTIONS TO REFLECT MEDICARE PART D)**

As we have discussed, on May 19 FASB issued the final FSP 106-2 to provide guidance on accounting for the financial effects of the 2003 Medicare Modernization Act (FSP 106-1 is superseded upon adoption of FSP 106-2). The FSP offers options for employers to consider in reflecting the effects for Medicare Part D in 2004. These options include:

- Reflecting the plan's eligibility for the federal subsidy. The FSP presumes that actuarial equivalence will be based on the employer's share of the cost (total cost less employee contributions). The FSP allows actuarial equivalence to be assessed for accounting purposes by groups of plan participants, rather than for the plan as a whole. In PPL's case, we believe that it is likely that retirees prior to 4/1/1993 (uncapped retirees) will be eligible for the subsidy long term, while capped retirees may only be eligible for a certain number of years.
- Changes in assumed participation rates, per capita claims cost and health care trend rates for 2006 and beyond.

This FSP is effective for fiscal quarters beginning after June 15, 2004 and employers may adopt retroactively or prospectively.

In terms of accounting for the Act, PPL has four options:

	<b>Adopt Retroactively</b>	<b>Adopt Prospectively</b>
<b>Adopt 2nd Quarter 2004</b>	<ul style="list-style-type: none"> <li>■ Restate 1<sup>st</sup> quarter earnings</li> <li>■ Discount rate of 6.25%</li> </ul>	<ul style="list-style-type: none"> <li>■ Three quarters of recognition in 2004</li> <li>■ Moody's AA yield on March 31, 2004 was 5.75%, suggesting a discount rate of 5.75% or 6.00%</li> </ul>
<b>Adopt 3rd Quarter 2004</b>	<ul style="list-style-type: none"> <li>■ Restate 1<sup>st</sup> and 2<sup>nd</sup> quarter earnings</li> <li>■ Discount rate of 6.25%</li> </ul>	<ul style="list-style-type: none"> <li>■ Two quarters of recognition in 2004</li> <li>■ Moody's AA yield as of close of business on June 18, 2004 was 6.16%, suggesting a discount rate of 6.25%</li> </ul>

It is our understanding that PPL will most likely adopt FSP 106-2 effective with the 3<sup>rd</sup> quarter.

Mr. Don Sparaco  
Mr. T. W. Hatten  
June 21, 2004  
Page 4.

  
**TOWERS  
PERRIN**  
HR SERVICES

The following chart illustrates the impact on 2004 FAS 106 results for the whole year assuming that the federal subsidy only applies to uncapped retirees, with no other changes in assumptions.

\$ millions	APBO	Service Cost	FAS 106 Expense	Change
2004 Final Results (based on revised substantive plan)	\$451	\$5.7	\$36	--
2004 Results (reflecting effects from Medicare Part D)	\$445	\$5.7	\$35	(\$1)

We plan to discuss PPL's options and decision points in more detail during our meeting on July 12<sup>th</sup>. We anticipate providing some additional options at that time.

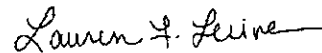
\* \* \* \* \*

Don and Sunny, we hope that you find this information useful. We would like to schedule a conference call with you once you have had a chance to review this information. In the meantime, please call us with any questions.

Sincerely,



A. Paul Kienzle III, FSA  
Principal  
Direct Dial: 215-246-7390



Lauren F. Levine, FSA  
Consultant  
Direct Dial: 215-246-7869

Attachment

cc: Tom Croyle, PPL Corporation  
Susan Paule, PPL Corporation  
George Sunder, PPL Corporation  
Royce Kosoff, Towers Perrin

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**DOCUMENT**

**DOCKETED**  
JUL 28 2004

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-00049255**

**PPL ELECTRIC UTILITIES CORPORATION**

**Statement No. 3-R**

**Rebuttal Testimony of David R. Woodruff**

1 Q. Please state your name, title, and business address.

2 A. David R. Woodruff, Manager – Load Analysis for PPL Electric Utilities,  
3 Two North Ninth Street, Allentown, Pennsylvania, 18101.

4

5 Q. Mr. Woodruff, have you testified previously in this proceeding?

6 A. Yes, I submitted direct testimony, Statement 3, on March 29, 2004.

7

8 Q. What is the purpose of your rebuttal testimony?

9 A. I will respond to the direct testimony of Mr. Kubas of the Office of Trail  
10 Staff, in which he concluded that "present rate revenue for the residential  
11 heating rate schedule be increased by \$15,109,000."

12

13 Q. Please summarize your rebuttal testimony.

14 A. Mr. Kubas has made several errors and inappropriate assumptions in his  
15 analysis. Specifically, his analysis over-estimates the weather impact on  
16 sales to electric heat customers. Further, I will show that PPL Electric's  
17 forecast of sales to electric heat customers for the 2004 future test year  
18 has been accurate year-to-date.

19

20 **2004 Sales Forecast**

21

22 Q. What errors are contained in Mr. Kubas' analysis?

23 A. Mr. Kubas makes several errors in his analysis:

- 1 • In OTS Exhibit No. 3, Schedule 2, Page 2 of 2, Mr. Kubas shows  
2 the Heating Degree Days (HDDs) for December 2002. Exhibit  
3 DRW-2, Page 1 of 2, Table 1 shows that the average of the Wilkes-  
4 Barre/Scranton, Allentown, Harrisburg/Middletown, and  
5 Williamsport weather stations using this data is 1,095 HDDs.  
6 However, OTS Exhibit No. 3, Schedule 6, is used to calculate the  
7 average HDDs that are used in Mr. Kubas' analysis. This schedule  
8 lists the average HDDs for these 4 weather stations, and shows the  
9 December 2002 average as 812 HDDs. In the calculation of the  
10 total HDDs on Schedule 6 for all months, Mr. Kubas incorrectly  
11 included only 3 weather stations (he neglected to include the  
12 Williamsport value in the total shown in Column F), but calculated  
13 the average in Column G by dividing the total by 4. This calculation  
14 by Mr. Kubas is shown in Exhibit DRW-2, Page 1 of 2, Table 1.  
15 *This error resulted in a substantial under-calculation of the HDDs*  
16 *used to calculate the Normalized Load shown in OTS Exhibit No. 3,*  
17 *Schedule 7 (812 HDDs vs 1095 HDDs). This error accounts for*  
18 *90% of the increase proposed by Mr. Kubas in the present rate*  
19 *revenue for the residential heating rate schedule.*  
20 • In calculating actual HDDs, Mr. Kubas also makes an error in  
21 calculating the normal HDDs. He used the NOAA data in OTS  
22 Exhibit No. 3 to calculate the Normal HDDs. Harrisburg/Capital  
23 City station data was used in this calculation. However, in

1 calculating the actual HDDs on Schedule 6, the  
2 Harrisburg/Middletown station data was used. PPL Electric uses  
3 Harrisburg/Middletown station in all its calculations.

- 4 • The actual sales figures used by Mr. Kubas in OTS Exhibit No. 3,  
5 Schedule 7 for June and July 2002 are incorrect. PPL Electric  
6 provided the actual values in its response to OTS Interrogatory  
7 OTS-RE-8.

- 8 • In OTS Exhibit No. 3, Schedule 5, Page 1 of 3, the bills breakdown  
9 allocates Rate Schedule RTS and Rate Schedule RTD customers  
10 to both heating and non-heating. All of the Rate Schedule RTS and  
11 Rate Schedule RTD customers are electric heat customers.

12  
13 Q. What inappropriate assumptions does Mr. Kubas employ?

14 A. The forecast PPL Electric produces is a forecast of revenue-month sales.  
15 In OTS Exhibit No. 3, Schedule 7, Mr. Kubas attempts to normalize  
16 revenue-month sales using calendar-month weather data. Any  
17 comparison of monthly sales and weather must be done on the same  
18 basis. Bills are rendered to customers throughout the month and,  
19 therefore, revenue-month sales will not directly correspond to calendar-  
20 month HDDs and Cooling Degree Days (CDDs). For example, if one  
21 makes the simplifying assumption that customers are billed the same time  
22 every month, then a customer who is billed on the 15<sup>th</sup> day of each month  
23 will have half of his usage in the current month and half of his usage in the

1 prior month. In order to make a comparison of revenue-month sales and  
2 weather, the weather data must be adjusted to show the HDDs applicable  
3 to the usage in the current month, and the HDDs applicable to the usage  
4 in the prior month. In reality, customer meter reads are not the same time  
5 every month, and the number of billing days will vary. The HDDs and  
6 CDDs for all 20 billing controls must be calculated on a daily basis in order  
7 to place the sales and weather data on the same revenue-month basis.  
8 As explained in the response to OTS Interrogatory OTS-RE-6, the  
9 revenue-month values are calculated in PPL Electric's forecast model  
10 based on meter reading schedules.

11 Prior to 1985, PPL Electric had used calendar-month HDDs and  
12 CDDs. PPL Electric recognized this inherent weakness in using calendar-  
13 month HDDs and CDDs and began using revenue-month HDDs and  
14 CDDs, based on daily degree days.

15 Mr. Kubas' analysis also ignores the impact of the summer cooling  
16 season on annual normalized sales. A large number of electric heat  
17 customers also have electric air conditioning. Mr. Kubas uses the actual  
18 sales from June 2002 through September 2002 in his calculation of  
19 normalized load. Because the summer of 2002 was hotter than normal,  
20 the normalized load would be less than actual for the cooling season.  
21 This would further reduce the total annual normalized load.

22  
23 Q. Do you agree with Mr. Kubas' explanation of customers' Base Load?

1 A. No. Mr. Kubas makes the assumption that all usage above an October  
2 Base Load is due to weather. This results in Mr. Kubas overstating the  
3 impact of weather. In reality, usage will vary month-by-month due to other  
4 variables. Lighting requirements are higher during the winter due to the  
5 reduced hours of daylight. Holiday lighting adds additional load  
6 requirements. During the summer, Base Load requirements will be  
7 reduced due to reduced lighting needs, more outdoor activities, and  
8 vacations. For these reasons, PPL Electric's forecast model includes  
9 monthly and lighting variables to account for these differences in usage  
10 throughout the year.

11 Finally, Mr. Kubas includes May as a heating month, when the  
12 actual and normal HDDs are lower than his Base Load month of October.  
13 May is not considered to be part of the heating season, and should have  
14 been excluded from this analysis.

15  
16 Q. You also mentioned the forecast model used by the Company to forecast  
17 sales. Mr. Kubas says you refused to provide a working copy. Is this  
18 true?

19 A. As explained in the response to OTS Interrogatory OTS-RE-7, the request  
20 for the model was for an Excel version. PPL Electric's sales forecast  
21 model is not in an Excel format, rather it is in a proprietary software  
22 program, Metrix ND, developed by RER, Inc. I do not know if OTS has a  
23 license for this and other software products (such as SQL Server) required

1 to run the model. The sales forecast model also is installed on a server,  
2 and requires access to PPL Electric's network in order to operate. For  
3 these reasons, PPL Electric could not provide the model to the OTS. And,  
4 in any event, as I explained in OTS Interrogatory OTS-RE-6, 30-year data  
5 is not available on a revenue-month basis. So, even if we had provided  
6 the model and access to the server, OTS would not have been able to use  
7 it to make a 30-year calculation.

8  
9 Q. Mr. Kubas states that several inputs and assumptions in the model are  
10 incorrect. Is this true?

11 A. No. Mr. Kubas states that PPL Electric's weather data is not official NOAA  
12 data. PPL Electric obtains the weather data from Meteorlogix.  
13 Meteorlogix obtains its weather data from the weather monitoring  
14 equipment at the respective airports. This equipment is installed and  
15 maintained by either NOAA or the FAA. The hourly weather data from  
16 each airport is sent to a NOAA facility in the Washington, DC / Maryland  
17 area. Meteorlogix receives the hourly weather data via a direct line from  
18 this facility. PPL Electric receives its hourly data from Meteorlogix via a  
19 File Transfer Protocol site on a daily basis. This file contains hourly  
20 observations from midnight to midnight for the prior day. These weather  
21 files that PPL Electric receives from Meteorlogix contain clean data that  
22 excludes any erroneous observations and includes estimates of any

1 missing values. This data is reviewed by the meteorologists at  
2 Meteorlogix.

3 Mr. Kubas made a second point about the long-standing policy of  
4 using 30 years of data to determine "normal" weather and HDDs. As  
5 stated in the response to OTS Interrogatory OTS-RE-6, PPL Electric uses  
6 a 20-year rolling average because the meter reading schedules prior to  
7 1980 are not available. These schedules are required to develop the  
8 revenue-month HDDs and CDDs.

9 Also, PJM has established a standard summer peak demand  
10 process that incorporates a 20-year rolling average weather parameter  
11 (PJM Manual 19: Load Data Systems, Section 4). PPL Electric also  
12 provides PJM with monthly sales forecasts. In order to be consistent with  
13 the PJM requirements, PPL Electric elected to use a 20-year rolling  
14 average in its process of obtaining sales on a normal-weather basis.

15

16 Q. How does Mr. Kubas' estimate of residential heating sales for the future  
17 test year compare to PPL Electric's forecast when compared to 2003  
18 actual and weather-normalized sales?

19 A. Mr. Kubas estimated normalized usage for the future test year as  
20 7,132,142,893 kWh (OTS Exhibit No. 3, Schedule 7, Column J, Line 14).  
21 PPL Electric provided actual and normalized residential heating sales in  
22 Attachment 1 of the response to OTS Interrogatory OTS-RE-33. Mr.  
23 Kubas' value of 7,132,142,893 kWh would result in an increase over 2003

1 actual sales to residential heating customers of 10.4%, and 12.7% over  
2 2003 normalized sales.

3 PPL Electric's forecast of residential heating sales, however, is for  
4 a more modest growth of 1.6% over 2003 actual and 3.7% over 2003  
5 normalized, as shown in Exhibit DRW-2, Page 2 of 2, Table 2.

6  
7 .Q. The future test year is now half over. How has PPL Electric's forecast of  
8 sales for residential heating customers compared to actual and weather-  
9 normalized sales?

10 A. Exhibit DRW-2, Page 2 of 2, Table 3 compares electric heat sales to  
11 forecast. For the first half of 2004, sales to PPL Electric's electric heat  
12 customers is 0.5% above forecast. On a weather-normalized basis, actual  
13 sales are 1.8% below forecast.

14  
15 Q. Does this conclude your testimony?

16 A. Yes it does.

**PPL ELECTRIC UTILITIES CORPORATION**

**Exhibit DRW-2**

**Table 1: Calculation of Heating Degree Days Based on  
Published NOAA Data – Comparison of PPL Electric’s  
Calculation vs. OTS’s Calculation**

**Table 2: Comparison of PPL Electric’s Forecast vs. OTS’s  
Forecast – 2003 to 2004 Growth**

**Table 3: Electric heat Customers – Comparison of Forecast vs.  
Actual Sales**

**Witness: David R. Woodruff**

Table 1  
Calculation of Heating Degree Days Based on Published NOAA Data  
Comparison of PPL Electric's Calculation vs. OTS's Calculation  
December 2002

(A)	(B)	(C)	(D)	(E)	(F) (B+C+D+E)	(G) (F / 4)
<b>PPL Electric</b>						
	Allentown	Harrisburg	Scranton	Williamsport	Total	Average
December 2002	1091	1047	1110	1130	4378	1095
<b>OTS</b>						
	Allentown	Harrisburg	Scranton	Williamsport	Total	Average
December 2002	1091	1047	1110	*	3248	812 **

\* Shown on OTS Exhibit No. 3, schedule 6 but omitted in calculation of Total.

\*\* Average in OTS calculation is Total of 3 weather stations divided by 4.

**Table 2**  
**Comparison of PPL Electric's Forecast vs. OTS's Forecast**  
**2003 to 2004 Growth**  
**(MWh)**

	A	B	C	D	E	F
	2003	2004	(B - A) / A	2003	(A + D)	(B - E) / E
Forecast	Actual	Forecasted	% Growth	Weather Adjustment <sup>1</sup>	2003 Weather-normalized Actual	% Growth
PPL Electric	6,460,237	6,563,165	1.6%	(131,767)	6,328,470	3.7%
OTS	6,460,237	7,132,143	10.4%	(131,767)	6,328,470	12.7%

**Table 3**  
**Electric Heat Customers**  
**Comparison of Forecast vs. Actual Sales**  
**(MWh)**

Monthly								
	A	B	C	D	E	F		
	2004	Forecast	Actual	(B - A) / A	Weather Adjustment	(B + D)	Weather-normalized Actual	% Fcst Error
1	879,522	847,503	-3.6%	(7,971)	839,532	-4.5%		
2	835,129	912,067	9.2%	(94,940)	817,127	-2.2%		
3	746,854	721,059	-3.5%	11,191	732,250	-2.0%		
4	578,551	568,846	-1.7%	(6,429)	562,417	-2.8%		
5	399,049	395,038	-1.0%	12,481	407,519	2.1%		
6	344,438	357,536	3.8%	(559)	356,977	3.6%		
7	388,299							
8	397,609							
9	356,473							
10	382,501							
11	530,071							
12	724,669							
Cumulative YTD								
	A	B	C	D	E	F		
	2004	Forecast	Actual	(B - A) / A	Weather Adjustment	(B + D)	Weather-normalized Actual	% Fcst Error
1	879,522	847,503	-3.6%	(7,971)	839,532	-4.5%		
2	1,714,651	1,759,570	2.6%	(102,911)	1,656,659	-3.4%		
3	2,461,505	2,480,629	0.8%	(91,720)	2,388,909	-2.9%		
4	3,040,056	3,049,475	0.3%	(98,149)	2,951,326	-2.9%		
5	3,439,105	3,444,514	0.2%	(85,668)	3,358,846	-2.3%		
6	3,783,543	3,802,050	0.5%	(86,227)	3,715,823	-1.8%		

**Notes:**

1 PPL Electric's Weather Adjustment used to adjust actual for both comparisons.

**DOCUMENT**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**DOCKETED**

JUL 28 2004

**Docket No. R-00049255**

**PPL Electric Utilities Corporation**

**Statement No. 4-R**

**Rebuttal Testimony of Douglas A. Krall**

1 Q. Please state your full name and business address.

2 A. My name is Douglas A. Krall. My business address is Two North Ninth Street,  
3 Allentown, Pennsylvania, 18101.

4 Q. By whom are you employed and in what capacity?

5 A. I am employed by PPL Electric Utilities Corporation ("PPL Electric" or the  
6 "Company") a subsidiary of PPL Corporation. I work in the Asset Management  
7 Department of PPL Electric and my title is Manager – Regulatory Strategy.

8 Q. Have you provided testimony previously in this proceeding?

9 A. Yes, I have. I provided written direct testimony that was designated as  
10 Statement No. 4. I also provided Exhibit DAK1.

11 Q. Please describe the purpose of your rebuttal testimony.

12 A. The purpose of my rebuttal testimony is to address issues raised by other parties  
13 regarding the following:

- 14 • The inclusion of plant held for future use in base rates.
- 15 • PPL Electric's proposal to establish a Distribution System Improvement  
16 Charge ("DSIC").
- 17 • Issues related to PPL Electric's proposed Transmission Service Charge  
18 ("TSC").
- 19 • PPL Electric's proposed allocation of distribution revenue requirements.
- 20 • PPL Electric's request to amortize and recover from customers costs  
21 associated with Hurricane Isabel.
- 22 • Costs and benefits associated with the Automated Meter Reading ("AMR")  
23 system.

- Proposals offered by Strategic Energy to promote retail competition.

Q. Are you sponsoring additional exhibits as part of your rebuttal testimony?

A. Yes, I am. Exhibits DAK2, DAK3 and DAK4 are attached.

#### Plant Held for Future Use

Q. Please describe PPL Electric's request in this proceeding for plant held for future use.

A. In my direct testimony, I stated that PPL Electric is making a claim to include in rate base \$2,212,678 related to distribution plant held for future use. I further stated that if this claim is not approved by the Commission, PPL Electric, in the alternative, is requesting approval to accrue a return equivalent to the applicable AFUDC rate on these investments and to include the accrued amount as part of its distribution plant in-service at the time such plant is placed into service.

Q. OCA witness Lafayette Morgan has recommended that the Commission accept PPL Electric's alternative request and allow the Company to accrue AFUDC on those specific parcels of land subject to normal regulatory oversight at the time the Company requests such plant be placed into service. Does the Company accept this proposal?

A. Yes, the Company does. An appropriate adjustment to rate base is reflected in Revised Exhibit Future 1.

#### Distribution System Improvement Charge

Q. Please describe PPL Electric's proposal to establish a DSIC.

A. The DSIC that PPL Electric has proposed is a rate mechanism that would allow the Company to recover, between formal rate cases, the carrying costs on

1 certain capital investments in distribution facilities. In the absence of DSIC, PPL  
2 Electric can not collect any money from customers to support these investments  
3 in facilities until they are recognized as additions to rate base in the context of a  
4 formal rate proceeding. This situation can go on for years and is becoming  
5 increasingly critical as distribution facilities built in the high growth 1960s, 1970s,  
6 and 1980s are nearing the end of their useful lives. The DSIC will enable PPL  
7 Electric to begin collecting money to cover the carrying costs of these facilities  
8 shortly after the facilities are completed and begin providing service to  
9 customers. As a result, PPL Electric will be better able to finance the  
10 construction of facilities that are required to maintain safe and reliable service  
11 without the immediate need to file a formal base rate case.

12 Q. Please describe the issues raised by other parties relative to this proposal.

13 A. OCA witness Thomas Catlin and OTS witness Michael Gruber argue that PPL  
14 Electric's proposed DSIC is illegal under the Pennsylvania Public Utility Code  
15 and represents improper single-issue rate-making. PPLICA witness Stephen  
16 Baron, DOD witness Thomas Prisco, and OSBA witnesses Robert Knecht and  
17 Mark Ewen echo the criticism that DSIC represents improper single-issue rate-  
18 making. OCA witness Catlin and OSBA witnesses Knecht and Ewen also argue  
19 that verification is problematic. OTS witness Gruber also questions the inclusion  
20 of substation equipment and security improvements as DSIC-eligible property.  
21 PPLICA witness Baron also questions the need for DSIC and, along with DOD  
22 witness Kenneth Kincel and OSBA witnesses Knecht and Ewen, the  
23 appropriateness of a kWh-based recovery mechanism. OSBA witnesses Knecht

1 and Ewen also question the necessity for DSIC. Witness Eric Epstein argues  
2 that DSIC is illegal, discriminatory, and should not address security  
3 improvements.

4 Q. How do you respond to the argument that DSIC constitutes improper single-issue  
5 rate-making?

6 A. That argument is not correct. Although PPL Electric will respond fully to such  
7 legal arguments in its briefs, counsel has provided me with a brief overview of  
8 PPL Electric's position on the legality of its proposed DSIC.

9 The contentions of other parties, that the DSIC is unlawful, ignore the fact  
10 that Section 1307(a) of the Public Utility Code, 66 Pa.C.S. § 1307(a), expressly  
11 authorizes automatic adjustment clauses, subject to the Commission's approval.  
12 The parties who contend that single issue ratemaking is unlawful are incorrectly  
13 reading Section 1307(a) out of existence. Of course, PPL Electric must  
14 demonstrate to the Commission that the proposed DSIC is in the public interest,  
15 but there is no blanket rule that automatic adjustment clauses governing recovery  
16 of an expense or class of expenses are unlawful.

17 Q. Certain parties contend that PPL Electric's proposed DSIC is not proper because  
18 there is no specific authority for it similar to Section 1307(g) which authorizes  
19 DSICs for water utilities. Do you agree with those comments?

20 A. No, I do not. PPL Electric will explain fully in its briefs why the absence of a  
21 specific authorization for its proposed DSIC, such as Section 1307(g) for water  
22 utilities, does not preclude the Commission from approving PPL Electric's DSIC.  
23 I note, however, that the Commission approved a DSIC for a water utility before

1 Section 1307(g) of the Public Utility Code was enacted. Section 1307(g) was  
2 enacted into law under the Act of December 18, 1996, P.L. 1061, No. 156, § 1,  
3 effective on February 16, 1997. Previously, in an Order entered on August 26,  
4 1996, the Commission approved a form of DSIC in *Re: Pennsylvania-American*  
5 *Water Company*, Docket No. P-00961031, 86 Pa. PUC 415 (1996). The  
6 Commission obviously concluded that a specific statutory authorization to create  
7 a DSIC for water utilities was not required and concluded also that DSICs meet  
8 the requirements of Section 1307(a) of the Public Utility Code.

9 Further, since the enactment of Section 1307(g), the Commission has  
10 approved a similar tariff provision, a Collection System Improvement Charge  
11 ("CSIC"), for a wastewater company despite the absence of any specific statutory  
12 authorization for such an automatic adjustment clause.

13 Specifically, the CSIC for Pennsylvania-American Water Company's  
14 sewer divisions was implemented pursuant to the Commission's approval in *Pa.*  
15 *P.U.C. v. Pennsylvania-American Water Co.*, Docket No. R-00027982  
16 (November 9, 2003). There, the Commission approved the CSIC despite the  
17 facts that wastewater or sewer utilities are not mentioned in Section 1307(g) and  
18 that there is no other statutory provision specifically authorizing a CSIC for sewer  
19 or wastewater utilities. I should note that the OCA has appealed the  
20 Commission's approval of the CSIC. The appeal is presently pending before the  
21 Pennsylvania Commonwealth Court at Docket No. 2497 C.D. 2003.

22 Q. How do you respond the criticism that verification of DSIC will be problematic?

1 A. PPL Electric knows of no reason why an electric DSIC should be more difficult to  
2 administer and verify than a water DSIC or a sewer utility CSIC.

3 Initially, I note that water and sewer companies are subject to the same  
4 alleged "incentives" to classify as many property additions as possible as being  
5 subject to the DSIC or CSIC. Nevertheless, the water and sewer companies and  
6 the Commission have not experienced, to my knowledge, substantial controversy  
7 with regard to these matters. It is my understanding that the Commission's  
8 Bureau of Audits periodically reviews the plant additions of water utilities that are  
9 reflected in the water utilities' DSICs and that there has not been substantial  
10 controversy with regard to these matters.

11 Further, PPL Electric's proposed DSIC explicitly specifies the categories of  
12 property that are eligible for the DSIC as follows:

- 13 • Poles (Account 364) oil circuit reclosures (Account 365), underground  
14 cable (Account 367) and underground services (Account 369) installed as  
15 in kind replacements,
- 16 • Area supply substation equipment (Account 362) replacements due to  
17 deterioration, failure, or obsolescence to maintain reliability,
- 18 • Unreimbursed costs related to capital projects that relocate Company  
19 facilities due to highway relocation work,
- 20 • Distribution line circuit capital replacements to maintain reliability, and  
21 security improvements.

22 By tying the eligibility of most plant additions to specific distribution plant  
23 accounts, PPL Electric has minimized its discretion with regard to eligibility for

1 the DSIC because these accounts are clear and well-defined under the Uniform  
2 System of Accounts.

3 Q. Are there any problems with including security improvements in the DSIC eligible  
4 property?

5 A. No, there are not. OTS witness Gruber and Witness Epstein take exception to  
6 the Company's proposal to include security improvements under the definition of  
7 DSIC-eligible property. Both argue that security improvements are more likely to  
8 involve the transmission system, and the Company does not disagree. In such a  
9 circumstance, however, costs related to security for transmission facilities would  
10 be included in the PJM Open Access Transmission Tariff (OATT) and collected  
11 from entities purchasing transmission service from PJM. However, the Company  
12 does not preclude the possibility that a governmental authority with appropriate  
13 jurisdiction might order security improvements to Company buildings or  
14 information systems that are defined as distribution property. The Company  
15 believes that recovery of such costs through a DSIC is consistent with the  
16 provisions of the Commission's Order regarding "government-imposed  
17 requirements." *Re: Pennsylvania-American Water Co.*, 86 Pa. PUC, *supra*, pp.  
18 419.

19 Further, as I made clear at page 36 of my direct testimony, PPL Electric  
20 Statement No. 4, security improvements would be limited to those recommended  
21 by a governmental authority with appropriate jurisdiction. There would be little, if  
22 any, discretion for PPL Electric with regard to security investments because the  
23 decisions would be made pursuant to governmental recommendations or

1 requirements. For this reason, there should be minimal controversy with regard  
2 to the eligibility of specific property additions for the DSIC.

3 Q. How do you respond to the assertion that substation equipment improvements  
4 should not be DSIC-eligible property?

5 A. OTS witness Gruber asserts that electric substation equipment is analogous to  
6 water pumping stations and, in reliance on a Commission Order in *Petition of the*  
7 *Columbia Water Company for Approval to Implement a Tariff through*  
8 *Supplement Establishing a Distribution Improvement Charge*, Docket No.  
9 P-00021979 (April 17, 2003) ("*Columbia*"), recommends that substation  
10 equipment not be eligible for recovery under DSIC. The Company initially  
11 responds that, regardless of whether water pumping stations are an appropriate  
12 analogy for electrical substations, the Commission's order in the cited case is not  
13 relevant because it addresses the proposed construction of a new water pumping  
14 station whereas the Company's proposal is for the recovery of costs related to  
15 the replacement of existing, deteriorated or failed substation equipment and not  
16 the installation of new substations. Indeed, the Company's proposal is consistent  
17 with the Commission's *Columbia* Order which states that the intent of DSIC "is to  
18 allow cost recovery for distribution system improvement projects requiring  
19 immediate implementation due to risk imposed by aging infrastructure or to  
20 government-imposed requirements." (*Columbia* Order, p. 14)

21 Furthermore, with regard to the inclusion of the pumping station, the  
22 Commission explained at pages 11 – 12 of the *Columbia* Order, the particular  
23 pumping station at issue there was an integral part of the facilities for providing

1 emergency water storage and treatment; it was not an integral part of the  
2 distribution system. At page 15 of the *Columbia* Order, the Commission  
3 explained that this was the basis for its decision that the pumping station be  
4 excluded from the DSIC. The Commission did not adopt any rule that pumping  
5 stations should never be included in a water utility's DSIC. The decision was  
6 instead based upon the unusual circumstances of that particular pumping station.  
7 The *Columbia* Order does not support the OTS' proposed exclusion of substation  
8 plant additions from PPL Electric's DSIC.

9 Unlike the pumping station at issue in *Columbia*, an electric substation is  
10 an integral part of PPL Electric's distribution system. Initially, I note that a small  
11 portion of PPL Electric's substations are related to transmission, not distribution,  
12 functions. By restricting substation equipment eligible for the DSIC to Account  
13 362, however, PPL Electric has restricted DSIC eligible substation additions and  
14 replacements to distribution operations and excluded transmission-related  
15 substations.

16 As I noted, such substations are an integral part of PPL Electric's  
17 distribution system. Electricity is delivered to PPL Electric's distribution system  
18 from electric generation stations at high transmission voltages. At substations,  
19 voltage levels are reduced to distribution voltage levels so that electricity can be  
20 safely provided to the public. Indeed, all electricity distributed by PPL Electric to  
21 customers (excluding customers who take service at transmission voltages) flows  
22 through substations. The argument that substations are not an integral part of  
23 PPL Electric's distribution system is erroneous.

1 Q. Have parties raised other issues with regard to the DSIC?

2 A. Yes, certain parties have indicated that approval of PPL Electric's proposed  
3 DSIC would create the possibility that PPL Electric could over achieve its allowed  
4 rate of return as a result of other revenue requirement reductions or increases in  
5 revenues that are not reflected in the proposed DSIC (OSBA Statement No. 1,  
6 p. 5; OCA Statement No. 2, pp. 6-7; DOD Statement of T. Prisco, p. 11; PPLICA  
7 Statement No. 1, pp. 46-50; Pa EC Statement No. 1, p. 11). Such concerns are  
8 unrealistic. Specifically, I note that, despite the many efficiencies and savings  
9 that PPL Electric has implemented since its last base rate case in 1995, PPL  
10 Electric's return on equity has continued to erode. In 2003, PPL Electric  
11 achieved a return on equity of less than 2 percent. Return on equity is expected  
12 to decline to about 1 percent in 2004 (PPL Electric Statement No. 1, p. 3).

13 Added to PPL Electric's history of declining returns on equity is the  
14 substantial nature of its construction budget. As set forth in Exhibit DAK-1, PPL  
15 Electric plans to spend on average almost \$200 million annually on construction  
16 through 2008. Only a small portion of these expenditures would be reflected on  
17 the DSIC, but this additional investment in new plant will drive increases in  
18 revenue requirements particularly with regard to depreciation, return and income  
19 taxes. The combination of the history of PPL Electric's declining returns on  
20 equity and its substantial and growing construction budgets suggest strongly that  
21 there is no realistic likelihood that PPL Electric will be able to achieve more than  
22 its allowed rate of return in the foreseeable future.

1 Further, PPL Electric submits to the Commission quarterly earnings  
2 reports pursuant to the requirements of 52 Pa. Code Ch. 71, regarding financial  
3 reports. Thus, the Commission has available for its review – four times each  
4 year – reports to determine whether PPL Electric is achieving more than its  
5 allowed rate of return. Such reports are available to the public. Therefore, any  
6 party who believes that PPL Electric is achieving more than its allowed rate of  
7 return can raise such matters for review in proceedings before the Commission.

8 Q. Certain parties have objected to PPL Electric's proposed DSIC on the grounds  
9 that certain of the plant additions eligible for the DSIC may reduce operation and  
10 maintenance expenses (OCA Statement No. 2). Are those concerns justified?

11 A. No, they are not. Initially it must be noted that only a small portion of PPL  
12 Electric's plant additions will be eligible for the DSIC. As I explained at page 38  
13 of my direct testimony, PPL Electric Statement No. 4, in a typical year, only about  
14 \$26 million of plant additions annually would be eligible for the DSIC. This  
15 amount should be contrasted with the totality of PPL Electric's construction  
16 program which is expected to be about \$200 million per year over the five years  
17 ending 2008. Thus, only about 13 percent of PPL Electric's construction and  
18 plant additions will be eligible for the DSIC. An investment of this magnitude will  
19 not have a substantial effect upon total operation and maintenance expenses.

20 The plant additions eligible for the DSIC will not cause PPL Electric's  
21 operation and maintenance expense to be reduced. It must be recalled that,  
22 each year, PPL Electric's distribution system is another year older. The small  
23 portion of the distribution system that will be replaced by property additions

1 eligible for the DSIC will not materially alter that process. The original cost of  
2 PPL Electric's total depreciable plant as of December 31, 2004, is  
3 \$4,398,361,788 (Exhibit JJS-1, p. III-5). Thus, DSIC eligible plant additions  
4 constitute only about 0.6 percent of PPL Electric's total original cost of plant (\$26  
5 million ÷ \$4,398 million). Although it is possible that operation and maintenance  
6 expense may be reduced for the particular distribution system component being  
7 replaced, there is no reason to believe that PPL Electric's overall operation and  
8 maintenance expenses will be reduced as a result of property additions eligible  
9 for the DSIC.

10 Q Certain parties have objected to the inclusion of depreciation on qualifying plant  
11 additions for recovery under the DSIC on the grounds that existing rates already  
12 have a provision for depreciation on the plant being replaced (OSBA Statement  
13 No. 1). *Are these concerns well-founded?*

14 A. No, they are not. Providing for depreciation recovery on qualifying plant  
15 additions is necessary to avoid having the Company experience attrition as a  
16 result of the qualifying plant addition.

17 On PPL Electric's books, under the Uniform System of Accounts, when old  
18 plant is retired and replaced by new plant, the plant balance and the accumulated  
19 reserve for depreciation both are adjusted by equal amounts to reflect the  
20 retirement of the old plant. Thus, there is no change in net plant as a result of  
21 retirement. Similarly, because PPL Electric's depreciation accrual rate applicable  
22 to the plant account in which the retired plant was recorded does not change as a  
23 result of any specific retirement, PPL Electric's depreciation accrual does not

1 change as a result of the retirement. The annual accrual per books is the result  
2 of applying the accrual rate to the net plant balance, and neither changes as a  
3 result of a retirement. Therefore, there should be no adjustment to depreciation  
4 expense due to the retirement of DSIC eligible property.

5 As a result of the plant addition, however, the plant balance to which the  
6 accrual rate is applied increases, and therefore, PPL Electric's annual  
7 depreciation accrual, per books, increases as a result of the plant addition. The  
8 treatment of depreciation related to replacement of plant eligible for the DSIC  
9 proposed by PPL Electric reflects PPL Electric's depreciation accounting per  
10 books, and it is appropriate for ratemaking to follow plant accounting in these  
11 matters. I note also that PPL Electric's DSIC proposal in this regard follows  
12 exactly procedures employed by water and sewer utilities in their Commission-  
13 approved DSICs or CSICs.

14 Q. How do you respond to the assertion that the Company has failed to demonstrate  
15 a need for DSIC?

16 A. PPLICA witness Baron asserts that the Company has failed to identify any  
17 "changed circumstances" that would necessitate the establishment of a DSIC.  
18 The Company responds that, in fact, circumstances have changed and, although  
19 the consequences of those changes have yet to be experienced, the Company's  
20 DSIC proposal is designed to avoid future adverse consequences that may be  
21 experienced by the Company and its customers. The "changed circumstances"  
22 that the DSIC proposal responds to are the aging of the Company's distribution  
23 *infrastructure*.

1           In analyzing its distribution plant, the Company has identified concerns  
2 regarding the age of plant and the fact that a significant amount of plant will need  
3 to be replaced in the not too distant future. Records show that 106,050 poles  
4 were installed during the 1950's, but with increased demand for electricity, that  
5 number grew to 184,104 installed during the 1960s and 234,046 installed during  
6 the 1970s before dropping to 157,424 during the 1980s and 136,530 during the  
7 1990s. As the large numbers of poles installed during the 1960s and 1970s age,  
8 the number of poles that will require replacement will grow dramatically.

9           Other plant accounts show similar results. This is not surprising because  
10 other areas of our nation's infrastructure including highways, bridges, water  
11 systems, and sewer systems also are aging. PPL Electric sees this as a  
12 "changing condition" and has proposed DSIC as a proactive measure to  
13 *anticipate an increasing need for capital to address the issues associated with*  
14 *aging infrastructure and to manage that issue so that it does not adversely*  
15 *impact customers.*

16 Q.   How do you respond to the criticism that collecting DSIC on a kWh basis is  
17 inappropriate?

18 A.   The Company believes that such a collection mechanism is appropriate based on  
19 the following considerations:

- 20 •   As proposed, DSIC would be limited to not more than 5% of distribution  
21 charges. This safeguard limits the amount of additional usage-based  
22 charges that can be reflected in rates.

- 1 • As proposed, the DSIC would be reset to zero in base rate proceedings so  
2 there would, in fact, be no usage-based charges for up to a year following  
3 a base rate proceeding.
- 4 • The annual review and reconciliation of a kWh mechanism is much  
5 simpler and more reliable than a reconciliation of a demand-based charge,  
6 the most likely other alternative, because residential demand is  
7 determined by load survey whereas usage is measured directly. The  
8 Company believes that this improves the auditability of DSIC.

9 Q. OSBA, DOD, PEC and PPLICA have argued that recovering the DSIC on a  
10 uniform amount per kWh basis caused a greater portion of DSIC costs to be  
11 recovered from large customers. Are these concerns valid?

12 A. These criticisms are arithmetically correct to the extent that recovery of DSIC  
13 expenses based upon a uniform amount per kWh would tend to recover  
14 proportionately more DSIC costs from large customers. In order to address  
15 these concerns, PPL Electric, as an alternative, is willing to calculate the DSIC as  
16 a percentage to be applied to distribution rates. In that way, DSIC recoveries  
17 would follow the Commission's allocations of plant in this proceeding as reflected  
18 in rates for distribution service. Use of a uniform percentage would reduce  
19 overall DSIC charges to large customers. I note that the DSICs of water  
20 companies are expressed as a percentage, and not as an amount per thousand  
21 gallons or hundred cubic feet of water. *Re. Pennsylvania-American Water Co.*,  
22 86 Pa. PUC, *supra*, p. 424. Thus, use of a uniform percentage applied to  
23 distribution rates would make PPL Electric's proposed DSIC similar to the DSICs

1 that the Commission has approved for water utilities and the CSICs that have  
2 been approved for sewer utilities.

3 Q. Witness Epstein asserts that the proposed DSIC is discriminatory because it  
4 would only be applied to customers taking service at 12,470 volts or below. How  
5 do you respond to the assertion that DSIC is discriminatory?

6 A. The Company proposes to exclude customers taking service above 12,470 volts  
7 because those customers are not served by the distribution system (other than  
8 metering, billing, and other common costs) and, therefore, do not benefit from the  
9 investments in the distribution system designated as eligible for collection under  
10 the proposed DSIC. The Company does not view its proposal as discrimination  
11 toward customers served at lower voltages, but rather as an issue of being fair to  
12 the customers who take service at the higher voltage levels.

13 Q. Some parties have argued that the annual process proposed by PPL Electric for  
14 its DSIC is unrealistic (OCA Statement No. 2, pp. 5, 9-10). Are such concerns  
15 valid?

16 A. No, they are not. Initially I note that the DSICs of water utilities and the CSICs of  
17 sewer utilities are filed quarterly, effective upon one month's notice. Re:  
18 *Pennsylvania-American Water Co.*, 83 Pa. PUC 415, 423 (1986). I am not aware  
19 of any procedural problems caused by these filings. PPL Electric also proposes  
20 to file its DSIC on one month's notice, but it will be filed only once each year,  
21 thereby imposing far less burden on the Commission than the DSICs of water  
22 utilities.

1           Given the fact that water DSICs have been in effect for approximately  
2 eight years, with rates changing four times each year upon one month's notice,  
3 there is no reason to believe that a similar process proposed by PPL Electric  
4 would be as difficult as has been suggested.

5           Further, PPL Electric itself has experience with changes of rates upon  
6 exactly the same schedule as the Company has proposed for the DSIC in this  
7 proceeding. This schedule has worked for the reconciliation and annual  
8 adjustment of PPL Electric's Intangible Transition Charges ("ITCs") and  
9 Competitive Transition Charges ("CTCs").

10 Q.    Certain parties have contended that the DSIC is inappropriate because it would  
11 permit rate changes without regulatory review of rates (OCA Statement No. 2,  
12 pp. 5, 10; PPLICA Statement No. 1, pp. 46-50). Are such concerns justified?

13 A.    No, they are not. Initially, I note that the rates would not change without  
14 Commission approval. Supplement No. 38 to Tariff – Electric Pa. P.U.C. No.  
15 201, p. 19Z.3. Further customers will have a full and fair opportunity to challenge  
16 the DSIC in general or the specific charge that is in effect at any time. If any  
17 customer affected by the DSIC wishes to challenge it, such issues could be  
18 raised in a standard complaint. PPL Electric's DSIC will not escape regulatory  
19 review.

20 Q.    Certain parties have contended that the DSIC is inappropriate because PPL  
21 Electric will need to implement accounting and information systems to track costs  
22 and identify specifically plant additions eligible for the DSIC (OCA Statement No.  
23 2, p. 9). Are these contentions justified?

1 A. No, they are not. Upon the Commission's approval of the DSIC, PPL Electric will  
2 implement all accounting and information systems that are needed to track DSIC  
3 plant additions, costs and revenues. PPL Electric will submit to the Commission  
4 information preserved through such systems in its annual filings and annual  
5 reconciliations. Again, as I have noted with regard to the water utility DSIC and  
6 the sewer utility CSIC, they present the same implementation issues as does  
7 PPL Electric's proposed DSIC, but substantial problems have not materialized  
8 with regard to the water utility DSICs or sewer utility CSICs.

9 Q. Are there any other points raised by other parties that you wish to address?

10 A. Yes. On page 17 of his testimony, Witness Epstein states, "Additionally, the '\$26  
11 million in property additions' that PPL believes is 'eligible' under DISC surcharge  
12 should be rejected in its entirety." If by this statement Witness Epstein means  
13 that no property additions should be eligible for recovery under DSIC, then I  
14 believe that I have already provided rebuttal testimony on that point. However, if,  
15 by his statement, Witness Epstein is saying that such additions should never be  
16 reflected in rate base, then the Company responds as follows:

- 17 1. The \$26 million represents the Company's estimate of plant additions in  
18 2005 that would meet its eligibility definition. Those additions are not being  
19 claimed as additions to rate base in this proceeding.
- 20 2. The Company believes that property additions that meet its eligibility  
21 definition represent prudent investments necessary to provide reliable  
22 service to customers that should be included in rate base.

**Transmission Service Charge**

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Q. Please describe the Company's proposal in this case regarding the establishment of a Transmission Service Charge ("TSC").

A. PPL Electric's current tariff permits it to charge all of its Provider of Last Resort ("POLR") customers for FERC-approved transmission charges. The Company has proposed a transmission rate tracking mechanism that would function in a manner similar to the former Energy Cost Rate. The proposed tracker would be reset annually to (1) reflect the current level of transmission charges and forecast of POLR sales and (2) a reconciliation of prior year collections to costs.

Q. Have other parties criticized PPL Electric's proposed TSC?

A. Yes. Several parties have opposed various portions of PPL Electric's proposed TSC. However, no party has opposed PPL Electric's recovery of its transmission service costs.

Q. Can you summarize those criticisms and respond to them?

A. Yes, I can. Several parties have indicated that, in their view, recovery of transmission service expenses should not be subject to reconciliation (OTS Statement No. 5, p. 13; PPLICA Statement No. 1, p. 28; Pennsylvania Energy Consortium Statement No. 1, p. 11). Such contentions are based, in part, on such parties' interpretations of various provisions of the Public Utility Code. PPL Electric will respond fully to such legal arguments in its briefs. My previous discussion of the legality of automatic adjustment clauses with regard to PPL Electric's proposed DSIC substantially applies also to the proposed TSC.

1           These parties contend also that, in their view, recovery of transmission  
2 service charges should not be subject to reconciliation as a matter of public  
3 policy. Such contentions are erroneous. Reconciliation of recovery of  
4 transmission service costs through an automatic adjustment clause is  
5 appropriate because the expenses are substantial, the expenses are subject to  
6 substantial variation and the variation is beyond the control of the utility.

7           Clearly, transmission service charges are substantial. As shown on  
8 Exhibit Future 1, Schedule D-3, page 1, projected transmission revenues to be  
9 collected from POLR customers during 2004 are approximately \$143 million,  
10 which is substantial especially when compared to PPL Electric's projected  
11 distribution revenues for the same period of \$500 million. For 2005, with the  
12 expiration of the rate cap, transmission service revenues are expected to  
13 increase by approximately \$57 million to match the actual amounts charged to  
14 PPL Electric by PJM. Thus, total transmission service charges for 2005 are  
15 expected to be approximately \$200 million (\$143 million + \$57 million) which is  
16 approximately 29 percent of PPL Electric's distribution revenues at proposed  
17 rates (\$200 million + \$688 million.) For distribution revenues at proposed rates,  
18 see Exhibit Future 1, Schedule D-1.

19           Although increases in transmission service charges may not be of this  
20 magnitude in the years immediately after 2005, the Company expects substantial  
21 annual changes in the levels of transmission service charges in the future.  
22 History supports this belief as transmission costs to serve POLR load have been  
23 \$139,950,000 in 2000, \$178,406,000 in 2001, \$170,329,000 in 2002, and

1 \$194,350,000 in 2003. Levels of transmission charges will vary in the future  
2 based upon the total amounts of transmission costs incurred by members of the  
3 PJM Interconnection, Inc. ("PJM"), changes in procedures under the PJM's Open  
4 Access Transmission Tariff ("OATT") by which transmission expenses are  
5 apportioned among the load serving members of the PJM such as PPL Electric  
6 and changes in the amount and seasonality of the peak and annual load of PPL  
7 Electric's POLR customers. PPL Electric's POLR customers' load data are the  
8 input from PPL Electric for the PJM transmission allocation procedures set forth  
9 in the OATT.

10 Further, PPL Electric's transmission service charges are not subject to its  
11 control. As indicated above, such charges are imposed under PJM's OATT.  
12 PPL Electric does not control PJM. Although PPL Electric is a voting member of  
13 the PJM, it casts only one vote among over 200 voting members. Furthermore,  
14 in accordance with PJM bylaws, the vote of the membership is simply a  
15 recommendation to the PJM Board which has ultimate decision-making authority.  
16 Thereafter, any change to PJM's OATT must be proposed to the Federal Energy  
17 Regulatory Commission ("FERC") for its consideration. It cannot be contended  
18 that PPL Electric controls the procedures under which transmission expenses are  
19 allocated to it.

20 Nor does PPL Electric control the basis on which these transmission  
21 expenses are allocated. The principal data which are used to allocate  
22 transmission expenses among load serving entities in the PJM are their  
23 contributions to the coincidental peaks of the PJM and their annual kWh usage.

1 Such factors are simply the accumulation of usage by all of PPL Electric's POLR  
2 customers. PPL Electric gathers the data and provides the data, but PPL Electric  
3 does not control the data. The data reflect customers' usage, and customers  
4 control their usage, not PPL Electric. Thus, PPL Electric cannot control any  
5 element of the process by which transmission service expenses are charged to it.

6 Q. Should PPL Electric's recovery of transmission expenses be subject to a  
7 prudence review, as suggested by the OTS (OTS Statement No. 5, p. 15)?

8 A. No, it should not. The OTS refers to the Commission's annual investigations of  
9 recovery of purchased gas costs by large local natural gas distribution  
10 companies under Section 1307(f) of the Public Utility Code as an example of an  
11 appropriate prudence review. OTS' analogy is flawed. In fact, when the annual  
12 reviews of purchased gas cost decisions are analyzed, they demonstrate why no  
13 prudence review is appropriate for transmission expenses.

14 As explained above, PPL Electric cannot control its charges from the PJM  
15 for transmission services under the OATT, which is part of a FERC-approved  
16 tariff. Total charges are based entirely upon procedures established by the PJM  
17 subject to FERC approval and by PPL Electric's POLR customers' usage. Nor  
18 can PPL Electric "shop around" for transmission services. PJM provides the  
19 transmission services and the cost of those services is governed by PJM's  
20 OATT. Therefore, there is no opportunity for transmission shopping on the PJM.

21 In contrast, local natural gas distribution companies, which are subject to  
22 annual Section 1307(f) investigations, can control many aspects of their  
23 purchased gas costs. Local natural gas distribution companies control the levels

1 of pipeline transportation and storage capacity for which they contract. It is  
2 possible for a local natural gas distribution company to contract for more capacity  
3 than needed to meet its customers' requirements. In addition, depending on the  
4 pipeline system, a local natural gas distribution company may be able to obtain  
5 pipeline capacity or storage capacity from any of several suppliers. Shopping for  
6 pipeline and storage capacity may be available.

7 Further, local natural gas distribution companies may choose among a  
8 wide variety of suppliers of natural gas for the commodity. Natural gas  
9 distribution companies also choose the type of contract under which they  
10 purchase natural gas. Natural gas may be purchased in the spot market or  
11 under longer term contracts and at variable or fixed rates. There is no equivalent  
12 for electric distribution companies with regard to transmission expenses on the  
13 PJM.

14 Local natural gas distribution companies make all of these decisions, and  
15 each of these decisions can have substantial impacts on customers. Because  
16 local natural gas distribution companies exercise substantial discretion over their  
17 natural gas purchases and transportation, it is reasonable for the Commission to  
18 review their use of such discretion to make certain that it was exercised for the  
19 benefit of the public.

20 Unlike local natural gas distribution companies, there is, as a practical  
21 matter, nothing for the Commission to review with regard to transmission service  
22 charges. PPL Electric realistically has no discretion with regard to the level of  
23 transmission expenses that it incurs on the PJM; there is no exercise of

1 discretion for the Commission to review. Therefore, a prudence review of PPL  
2 Electric's transmission expenses would be unnecessary and wasteful.

3 Q. OTS also contends that PPL Electric's present tariff does not provide for  
4 automatic pass through of transmission costs (OTS Statement No. 5, p. 15). Do  
5 you agree with that contention?

6 A. No, I do not. OTS correctly acknowledges that all rate schedules of PPL  
7 Electric's presently-effective tariff contain the following language:

8 "The Company will provide and charge for transmission service  
9 consistent with the PJM Open Access Transmission Tariff approved  
10 or accepted by the Federal Energy Regulatory Commission for  
11 customers who receive Basic Utility Supply [POLR] Service from  
12 the Company unless such customers obtain transmission service  
13 *from another provider.*"

14 This tariff language became effective pursuant to the Commission's approval of  
15 the "Joint Petition for Full Settlement of PP&L, Inc.'s Restructuring Plan and  
16 Related Court Proceedings" in the Final Order entered on August 27, 1998, in  
17 *Application of Pennsylvania Power & Light Company for Approval of its*  
18 *Restructuring Plan under Section 2806 of the Public Utility Code,*" at Docket No.  
19 R-00973954. All parties to that proceeding joined in the settlement. Pursuant to  
20 this tariff language, PPL Electric has charged POLR customers an unbundled  
21 rate for transmission service since January 1, 1999.

22 The OTS interpretation of the above-quoted provision of PPL Electric's  
23 tariff is inconsistent with its plain language. PPL Electric can "provide and

1 charge" for transmission service consistent with the PJM OATT only if PPL  
2 Electric can pass through its actual charges from the PJM to its POLR customers  
3 on a timely basis as the OATT is changed from time to time subject to FERC's  
4 regulatory review. Although the above-quoted tariff provision does not set forth  
5 the precise mechanics by which such results are to be accomplished, it does  
6 make clear that PPL Electric is to charge for transmission service consistent with  
7 the PJM OATT. OTS' proposal would render the above-quoted provisions of  
8 PPL Electric's tariff meaningless.

9 In essence, PPL Electric's TSC proposal in this proceeding merely  
10 provides specific procedures for implementation of the tariff provision established  
11 in PPL Electric's restructuring proceeding that permits PPL Electric to charge  
12 POLR customers for transmission service consistent with the PJM OATT.

13 Q. OTS contends that transmission service charges incurred by PPL Electric should  
14 be recovered as "an unbundled transmission rate that is non-reconcilable" (OTS  
15 Statement No. 5, p. 13). Do you agree with this proposal?

16 A. No, I do not. The proposal is incorrect for the reasons which I have explained  
17 previously. If, however, the Commission were to determine that the OTS  
18 proposal should be adopted, and that PPL Electric should recover transmission  
19 expenses as an unbundled transmission rate that is not reconcilable, then the  
20 appropriate level of transmission service expenses to be recovered by PPL  
21 Electric based upon the best available information in this proceeding would be  
22 0.564 cents per kWh. This amount reflects the total amount of annual  
23 transmission service charges projected to be incurred by PPL Electric during the

1 2004 test year of \$198,973,679 divided by projected retail kWh sales of  
2 35,342,287,000 kWh. These figures reflect adjustments for price response and  
3 contract customers who pay for transmission service through those rates and the  
4 dollar amount reflects gross receipts tax at the rate of 59 mills. This information  
5 is contained in Exhibit DAK2.

6 Q. Is this also the rate PPL Electric proposes to charge in 2005 if the TSC is  
7 approved?

8 A. Yes. While PPL Electric's proposal for TSC involves end-of-year filings, that  
9 process must be modified this year in light of the expectation that the  
10 Commission will not issue a Final Order in this proceeding until December 2004.  
11 In order to address this situation, the Company wishes to establish in this  
12 proceeding that the transmission costs to be collected from POLR customers  
13 during 2005 are \$198,973,679 and that the associated rate, consistent with the  
14 Company's proposed collection mechanism, is 0.564 cents per kWh.

15 Q. Do you agree with OCA witness Morgan's comments regarding changes in PPL  
16 Electric's projections for revenues from Point-to-Point (PTP) service for 2004?

17 A. No. First it must be understood that the projected \$3.4 million dollar reduction in  
18 PTP revenues between the 2003 historic test year and the 2004 future test year  
19 was based on the assumption that the FERC order to eliminate regional through  
20 and out rates (RTORs) would be effective April 1, 2004 (not April 4, 2004 as  
21 stated by Mr. Morgan). The subsequent settlement (at FERC Docket No. EL01-  
22 111) postponed the elimination of RTORs until December 1, 2004. PPL Electric's  
23 update of its 2004 projected revenues from PTP service is \$4.1 million, which is

1 \$2.9 million, not \$3.4 million, lower than the 2003 historic test year revenues of  
2 \$7.0 million.

3 Q. Does the updated \$2.9 million decrease in the projected PTP revenues change  
4 the projected \$57.2 million increase in transmission service charges projected by  
5 PPL Electric?

6 A. No. The transmission revenue requirement which is projected to increase by  
7 \$57.2 million is based on the transmission service charges that PPL Electric  
8 expects to be billed by PJM under the PJM Open Access Transmission Tariff  
9 (OATT) as a Load Serving Entity (LSE) providing service to POLR customers.  
10 The revenues PPL Electric receives from PJM as its share of other parties' PTP  
11 reservations on the PJM system are recovered pursuant to FERC jurisdictional  
12 PJM agreements and consistent with PPL Electric being a transmission owner in  
13 PJM. The revenue PPL Electric receives as a transmission owner is separate  
14 and distinct from the transmission service charges PPL Electric incurs as a Load  
15 Serving Entity providing service to POLR customers. Revenues that PPL Electric  
16 receives as a transmission owner are reflected in Exhibit Future 1, Statement D-3  
17 on the line "Other Electric Revenues" under the heading "Transmission Rate  
18 Revenue." Both the costs and revenues associated with PPL Electric's provision  
19 of transmission service as a transmission owner have been removed from the  
20 distribution revenue requirement in this case. Thus, any adjustment would be to  
21 these figures and would not affect the Company's distribution revenue  
22 requirement or the transmission service charges it incurs as an LSE under the  
23 PJM OATT.

1 Q. Wouldn't the reduction in revenues to transmission owners ultimately reduce the  
2 amount paid by LSEs?

3 A. In theory, yes, but not for PPL Electric as a POLR provider. The adjustment  
4 identified by witness Morgan relates to PTP service, not Network Integration  
5 Transmission Services. PPL Electric, as an LSE, does not purchase PTP service  
6 to supply its POLR load. The change in PTP revenues, therefore, would not  
7 affect the costs it incurs as an LSE.

8 Q. Several parties have criticized PPL Electric's proposed allocation of transmission  
9 service charges among classes of customers based upon POLR energy sales,  
10 that is, a uniform amount per kWh, regardless of the customer class. Do you  
11 agree with such criticisms?

12 A. In my direct testimony, PPL Electric Statement No. 4, I explained that PPL  
13 *Electric's proposed allocation of transmission service charges among rate*  
14 *classes and customers within each rate class based on kWh of POLR sales is*  
15 *desirable for two important reasons. First, the proposed allocation is simple in*  
16 *that it is easily understood by customers and easily applied. Second, such*  
17 *allocation helped PPL Electric to meet its rate allocation objective of having no*  
18 *single rate class, as a whole, experience increases in its total bills in excess of*  
19 *10 percent. For these reasons, PPL Electric continues to believe that its initial*  
20 *proposed allocation of transmission service charges is preferable to alternatives*  
21 *suggested by other parties.*

22 Having said that, however, it must be acknowledged that pursuant to the  
23 PJM OATT, approximately 70 percent of transmission service charges incurred

1 by PPL Electric are allocated on the basis of POLR customers' contributions to  
2 coincident peaks on the PJM system; although, because only 27% of the load is  
3 recorded on interval meters, about 73% of this component is distributed to rate  
4 schedules and customers on a pro rata basis consistent with their kWh usage –  
5 not their actual demand. The remaining 30 percent of transmission service  
6 charges are allocated by PJM among load serving entities based upon kWh of  
7 sales.

8 In considering whether to re-allocate transmission charges, the  
9 Commission should be aware that allocations of transmission service expenses  
10 among customer classes or rate schedules based upon principles of cost  
11 causation could vary substantially from year to year. The reason for such  
12 substantial variation is that PPL Electric has experienced both winter and  
13 summer peaks. For example, over the last four years, PPL Electric has been a  
14 winter peaking company in 2000 and 2003 and a summer peaking company in  
15 2001 and 2002. Whether PPL Electric's load peaks in the summer or in the  
16 winter can change from year to year, and there is no clear trend that either  
17 summer peaking or winter peaking will become dominant in the near future.

18 If the Commission were to determine that transmission charges should be  
19 allocated based upon principles of cost causation, PPL Electric would reallocate  
20 charges annually, consistent with PJM OATT procedures, based upon its actual  
21 peak – either winter or summer – during the prior year ended November 30.  
22 Allocations among customer classes based upon summer peaks produces  
23 substantially different results from allocations based upon winter peaks.

1 To illustrate the effect of peaks in different seasons, I have calculated, for  
2 illustrative purposes, the allocations of transmission expenses and rates among  
3 the rate schedules based upon the winter peak in 2003 and the summer peak in  
4 2002. Exhibit DAK3 shows rates based upon allocations reflecting the 2003  
5 winter peak. Exhibit DAK4, in contrast, shows rates based upon allocations  
6 reflecting the 2002 summer peak. To make the rates comparable, these two sets  
7 of rates are designed to recover the same total amount of transmission charges.  
8 As can be seen by comparing the two schedules, the allocations among rate  
9 schedules and customer classes vary substantially based upon whether the 2002  
10 summer peak or 2003 winter peak is used to allocate transmission service  
11 charges. I note that this variability of the allocations among rate classes is a  
12 further reason why PPL Electric should recover transmission service charges  
13 based upon annual rate adjustments with reconciliation.

14 The rates in Exhibit DAK3 are illustrative of the rates that would go into  
15 effect on January 1, 2005, for recovery of transmission expenses if the  
16 Commission determines that PPL Electric should recover transmission charges  
17 through an unbundled transmission rate under which transmission charges are  
18 allocated among the rate schedules based upon principles of cost causation.  
19 The exact rates would be determined as part of PPL Electric's compliance filing.  
20 Under this proposal, the charges are allocated among rate schedules based  
21 upon the procedures set forth in the PJM OATT. Transmission charges would  
22 then be recovered within each rate schedule based upon a uniform rate per kWh.

1 Q. PPLICA has proposed that, for those classes of customers with interval meters,  
2 transmission rates be developed on a demand/energy basis to follow more  
3 precisely the PJM OATT procedures (PPLICA Statement No. 1, pp. 13-18). Do  
4 you agree with this proposal?

5 A. No. In my opinion, developing demand/energy rates for recovery of transmission  
6 charges within rate schedules for large customers is an unnecessary  
7 complication that will make little practical difference given the similar load  
8 characteristics of large customers. If the Commission were to approve the  
9 PPLICA proposal, however, it is critical that reconciliation be implemented on  
10 either a demand basis or an energy basis, but not both. Reconciliation over two  
11 rate elements would be extremely difficult to implement and administer.

12 Q. Do you have any other alternatives for consideration by the ALJ, the Commission  
13 and the parties?

14 A. Yes. Exhibit DAK3 also contains, as another alternative, illustrative rates for  
15 recovery of transmission charges for each of three broad classes of customers.  
16 This approach allocates transmission charges based upon principles of cost  
17 causation among three broad categories and recovers those transmission  
18 charges within each broad class based upon kWh of sales. The use of fewer  
19 groupings for recovery of transmission charges would promote rate stability and  
20 simplify administration of recovery of transmission expenses.

21 Under this alternative, the first class of customers would be all residential  
22 customers. The second class would include smaller commercial, industrial and  
23 municipal customers served under Rate Schedules GS-1, GS-3, BL, GH, IS-1.

1 and all lighting rate schedules. The third group of customers would be large  
2 customers served under all large power, interruptible and price response rate  
3 schedules. These are the same groups that are used for reconciliation of PPL  
4 Electric's Competitive Transition Charges ("CTCs") and Intangible Transition  
5 Charges ("ITCs"). Again, these rates are for illustrative purposes, only, and exact  
6 rates for 2005 would be calculated as part of the compliance filing.

7 Q. If the Commission were to decide that a portion of transmission service charges  
8 should be allocated on a demand basis, does PPL Electric have a specific  
9 proposal for reconciliation of transmission expenses under these circumstances?

10 A. Yes, PPL Electric does have such a proposal. As an alternative to PPL Electric's  
11 preferred method of recovering costs and reconciling recoveries based upon the  
12 uniform amount per kWh of sales, PPL Electric would be willing to follow a  
13 procedure very similar to those approved by the Commission in PPL Electric's  
14 restructuring proceeding for recovery and reconciliation of CTCs and ITCs.

15 PPL Electric would be willing to allocate costs among rate schedules  
16 based upon procedures set forth in PJM's OATT, as amended from time to time  
17 subject to FERC approval. PPL Electric, however, would reconcile recoveries  
18 with expenses not by individual rate schedule, but by the three broad classes of  
19 customers identified previously. The three groups of customers for reconciliation  
20 would be the same as those for the alternative proposal for recovery of  
21 transmission expenses. Reconciliation by large, broad groups, instead of  
22 individually by the numerous rate schedules will reduce volatility in rates due to  
23 small or variable kWh sales for the smaller, individual rate schedules. Using

1 broad categories for purposes of reconciliation also will reduce substantially the  
2 costs of administering the recovery of transmission charges.

3 **Allocation of Distribution Revenue Requirements**

4 Q. Please describe the Company's proposal in this case regarding the allocation of  
5 distribution revenue requirements.

6 A. While PPL Electric believes in the principle that customer rates should reflect the  
7 costs those customers place on the distribution system, there are certain aspects  
8 of this request that would result in significant disruptions to the rates of certain  
9 customer classes if that principle is strictly followed. PPL Electric believes that a  
10 gradual approach is appropriate and, accordingly, the allocations proposed by  
11 the Company are intended as a first step and reflect the following objectives:

- 12 1. Keep the increase on a total-bill basis to all residential rate schedules  
13 below 10%. "Total-bill" basis means that the allocation process included  
14 both the distribution increase proposed in this case and an estimate of the  
15 increase in the transmission service charge pass-through that will also  
16 occur on January 1, 2005.
- 17 2. Keep the increase on a total-bill basis to all rate schedules below 10%.
- 18 3. Bring the rate of return for customers taking service at 69,000 volts closer  
19 to the system average rate of return.

20 Q. Please describe the issues raised by other parties.

21 A. PPLICA witness Stephen Baron, DOD witness Kenneth Kincel, and OSBA  
22 witnesses Robert Knecht and Mark Ewen, while generally acknowledging that  
23 cost of service based allocations may be tempered by other factors, argue that

1 PPL Electric's proposal does not go far enough in the direction of cost-based  
2 allocations. Although the details of each witness's proposal are different, all  
3 recommend some amount of gradualism as evidenced by the fact that none  
4 recommends a strict adherence to cost causation principles. The disagreement  
5 appears, then, to not be one of approach, but one of degree.

6 Q. Do any parties agree with PPL Electric's proposal?

7 A. Yes. OCA witness Richard Galligan supports PPL Electric's approach. OCA  
8 witness Galligan observes, correctly in PPL Electric's opinion, that, when viewed  
9 as a whole, electric rates remain in a transitional period until the generation rate  
10 cap expires. It is, therefore, unnecessary and inappropriate to move rapidly to  
11 "correct" the allocation of distribution revenue requirements when other bill  
12 components that remain capped may continue to be "incorrect." PPL Electric  
13 agrees with OCA witness Galligan that "considerations such as gradualism,  
14 stability, understandability, acceptance, simplicity, etc." are important issues for  
15 commissions to factor into the setting of rates.

16 Q. Has the Company's proposal changed in light of the issues raised by PPLICA,  
17 DOD, and OSBA?

18 A. No, it hasn't. The Company continues to believe that the combined impact of  
19 changes in distribution rates and the transmission service charge pass-through  
20 should be considered in the context of their impact on the total bill. The  
21 Company also continues to believe that 10% is an important threshold, especially  
22 considering that electric rates are in the middle of a transition that will provide  
23 other opportunities, such as the completion of stranded recoveries, to achieve

1 additional "corrections" without introducing disruptive distortions of individual  
2 unbundled components.

3 Q. Does the Company have an opinion as to how proposed revenue allocations  
4 should be adjusted in the event that overall revenue requirements granted in this  
5 proceeding are lower than the amount requested by the Company.

6 A. PPL Electric believes that a proportional scale-back across all rate schedules  
7 would be the most appropriate approach. The Company acknowledges that the  
8 scale-back could be skewed across rate schedules in order to provide additional  
9 movement toward cost-based allocations. However, such an approach could be  
10 considered unfair from the perspective of a party who successfully advocated a  
11 revenue reduction, but then may not benefit from the result of that advocacy.  
12 Consistent with the views of OCA witness Galligan regarding gradualism, the  
13 Company believes that the incremental movement that might be achieved by a  
14 scale-back on a non-proportional basis, a departure from normal Commission  
15 practice, would be relatively small. When balanced against other considerations,  
16 such an approach would be inappropriate.

17 **Amortization and Collection of Hurricane Isabel Costs**

18 Q. Please describe the Company's request regarding the recovery of costs  
19 associated with Hurricane Isabel.

20 A. On October 20, 2003, PPL Electric requested Commission authority to defer, for  
21 accounting and financial reporting purposes, losses arising from severe damage  
22 caused by Hurricane Isabel and to amortize those losses for recovery from  
23 customers in a future base rate proceeding. Hurricane Isabel struck PPL

1 Electric's service territory most heavily during the evening of September 19, 2003  
2 and the morning of September 20, 2003. The losses which PPL Electric sought  
3 to defer were increases in operation and maintenance, customer, and general  
4 administrative expenses incurred by the Company in preparing to respond to the  
5 damage from Hurricane Isabel, restoring service to customers, assisting  
6 customers during the service interruptions, and repairing facilities damaged by  
7 the storm. In its petition, PPL Electric specifically acknowledged that it was not  
8 requesting that the Commission decide, at that time, whether its deferred losses  
9 were recoverable from customers. PPL Electric stated in its petition that  
10 approval to recover such losses as well as the length of the amortization would  
11 be determined in a future rate base proceeding. The Commission granted PPL  
12 Electric's request to defer storm-related losses for accounting and financial  
13 reporting purposes in an order entered on January 16, 2004 at Docket No.  
14 P-0032069. In this case, PPL Electric is requesting amortization of \$15 million in  
15 costs related to Hurricane Isabel over a period of five years. This request is  
16 included as an adjustment to Operating and Maintenance Expense in the future  
17 test year.

18 Q. Please describe the issues raised by other parties.

19 A. OCA witness Thomas Catlin argues that the costs were incurred during the  
20 period that distribution and transmission rates were capped and that, on advice  
21 of counsel, recovery of those costs subsequent to the expiration of the rate cap  
22 would constitute a de facto exception to the cap in violation of the Electricity  
23 Generation Customer Choice and Competition Act ("the Competition Act") and

1 PPL Electric's Restructuring Settlement (Docket No. R-00973954). OCA witness  
2 Catlin further argues that, in the event the Commission determines that these  
3 costs are recoverable, the portion of the \$15 million associated with regular  
4 salaries, wages, and benefits would have been incurred regardless of whether  
5 the Hurricane occurred and should, therefore, be excluded. OTS witness  
6 Charles Weakley also argues that regular salaries, wages and benefits should be  
7 excluded. OTS witness Weakley also argues that a 10 year amortization period  
8 is more appropriate. Witness Eric Epstein argues that collection of costs related  
9 to Hurricane Isabel would be a violation of the rate cap provisions of the  
10 Competition Act. Witness Epstein further argues that if the Company is entitled  
11 to rate recovery for extraordinary weather then consumers are also entitled to  
12 refunds when the loss of service due to those extraordinary conditions results in  
13 quantifiable hardships.

14 Q. How do you respond to the assertion that recovery of these costs would  
15 constitute a violation of the rate cap provisions of the Competition Act?

16 A. Counsel advises me that collection of these costs would not be a violation of the  
17 rate cap provisions of the Competition Act. The Competition Act specifies, in  
18 Section 2804(4)(1)(B), that "the charges of the utility for non-generation services  
19 that are regulated as of the effective date of this chapter...shall not exceed the  
20 non-generation charges that have been approved by the Commission for such  
21 service as of the effective date of this chapter." The Competition Act is silent on  
22 the issue of the recovery of costs incurred during the cap period except on the  
23 point that charges during the cap period cannot exceed the capped levels. PPL

1 Electric did not request these costs incurred in 2003 be recovered during 2004;  
2 i.e., during the cap period. PPL Electric requests that they be recovered starting  
3 in 2005; i.e., after the cap period. PPL Electric's request is entirely consistent  
4 with the Competition Act.

5 Q. How do you respond to the assertion that regular salaries, wages, and benefits  
6 should be excluded from any claim?

7 A. At the start of each year, the Company identifies a scope of work that is  
8 necessary to maintain its facilities and to assure an appropriate level of reliability.  
9 Activities included in that scope include tree trimming, inspections, testing,  
10 preventative maintenance, and repairs. Staffing plans are made consistent with  
11 the scope of work. When an event like Hurricane Isabel occurs, all available  
12 resources are engaged in storm-related restoration and repair and none of the  
13 planned scope of work is done. Nevertheless, that planned work must be  
14 completed within a reasonable period of time after storm-related work is  
15 completed and overtime and contracting are employed to get the work done.  
16 While the Company cannot identify each individual project that incurred  
17 contracting and overtime costs as a result of regular time and salaries being  
18 devoted to storm-related efforts, the regular salaries accumulated under the  
19 storm account provide an estimate of that impact. Such costs are real costs  
20 experienced by the Company as a result of the storm.

21 Q. How do you respond to the recommendation that these costs be amortized over  
22 a ten year period instead of a five year period?

1 A. OTS witness Weakley's only rationale for a longer recovery period is that "PPL  
2 has not experienced a storm the size of Hurricane Isabel for an extended period"  
3 and, therefore, should recover allowable costs over an extended period. In fact,  
4 the Company acknowledges that it has never in its 80 year history experienced a  
5 storm of the magnitude of Hurricane Isabel in terms of the number of cases of  
6 trouble. However, this does not mean that it would be appropriate to recover the  
7 costs of Hurricane Isabel over the next 80 years. The Company asserts that a  
8 five-year period is an appropriate "extended period". In making this assertion,  
9 the Company observes that it has not requested to recover a return on amortized  
10 amounts not recovered. Consequently, assuming a rate of return of 8.8%  
11 consistent with the Company's request in this proceeding, the proposed 5-year  
12 amortization will recover \$11.7 million on a present value basis or only 78% of  
13 the total amount. If OTS witness Wheatley's 10-year period is used, the recovery  
14 will be \$9.7 million or only 65% on a present value basis. The effect is to punish  
15 the Company for its efforts to restore customers and to accommodate their needs  
16 during this unprecedented event.

17 Q. How do you respond to the assertion that customers should be entitled to a  
18 refund as a result of storm-related outages?

19 A. Under the Public Utility Code, PPL Electric is required to maintain safe and  
20 reasonable service which shall be reasonably continuous. The Code does not  
21 require continuous service, nor does it suggest that utilities bear any liability  
22 when the service they provide is reasonably continuous. Consistent with the

1 requirements of the Code, Rule 4 of the Company's Commission-approved tariff  
2 (Tariff – Electric Pa. P.U.C. No. 201) states under the heading "F. Continuity":

3           “(1) The Company uses reasonable diligence to preserve  
4                       continuity of service, but in the event of interruption or  
5                       curtailment of service, Company shall not be subject to any  
6                       liability, penalty or payment for or on account of any such  
7                       interruption or curtailment...”

8 The Company does not propose any change to this language in this proceeding.

9           The intent of this language is to recognize that the Company cannot  
10           anticipate and prevent all possible interruptions to or curtailment of service. The  
11           Company's responsibility is to exercise reasonable diligence and, having done  
12           so, it should not be liable for the consequences of outages; especially, those  
13           caused by Hurricane Isabel as they are beyond the Company's reasonable  
14           control. It has not been suggested by any party that the Company failed in any  
15           way to exercise reasonable diligence in its efforts to prepare for or restore  
16           service following Hurricane Isabel.

17                               **Costs and Benefits Associated with AMR**

18 Q. Please describe the Company's request in this proceeding.

19 A. A significant portion of the benefits achieved by the AMR project is the  
20           elimination of manual processes associated with the prior metering system. With  
21           the elimination of manual processes comes the opportunity to reduce the  
22           workforce. PPL Electric estimates that the deployment of AMR will ultimately  
23           lead to a substantial reduction in the number of positions from what would have

1 otherwise existed without AMR. The displacement of employees carries with it  
2 certain costs. PPL Electric has been able to accommodate most of these  
3 displacements through normal attrition within PPL Electric; i.e., employees  
4 displaced by AMR have been trained to fill vacancies that arose as a result of the  
5 normal course of retirements and severance. However, with a displacement this  
6 large, the normal rate of attrition has not been enough. Accordingly, the  
7 Company offered enhanced severance benefits to 94 employees in order to  
8 capture the payroll and benefits savings of AMR. In this proceeding, the  
9 Company requested the authority to amortize the cost of these enhanced  
10 benefits over a five-year period and recover the resultant amounts through rates.

11 Q. Please describe the issue raised by other parties in regard to costs and benefits  
12 associated with the AMR project.

13 A. Parties raise a number of issues regarding the Company's request including the  
14 accounting treatment of these costs and the assertion that recovery of these  
15 costs in rates is a violation of the rate cap provisions of the Competition Act. The  
16 Company's response to these concerns is included in Statement No. 2-R, the  
17 Rebuttal Testimony of Joseph R. Schadt. The issue I wish to address is the  
18 assertion by OCA witness Thomas Catlin that "ratepayers would be better off  
19 without AMR if the amortization of the \$8,818,000 was allowed."

20 OCA witness Catlin correctly states that PPL Electric has performed an  
21 analysis of the total present worth of revenue requirements associated with the  
22 AMR system over a 15-year period. That analysis, as described in my direct  
23 testimony (PPL Electric Statement No.4), reflected quantifiable economic

1 benefits in the form of reduced expenses. However, Statement No. 4 also  
2 describes tangible benefits of a non-economic nature that customers are  
3 currently enjoying as well as future economic and non-economic benefits that will  
4 be available to customers as the AMR system is enhanced and as generation  
5 rate caps expire. Witness Catlin's assertion that ratepayers would be better off  
6 without AMR fails to recognize the benefits associated with more accurate billing,  
7 more complete usage information, and outage identification and restoration that,  
8 although not quantifiable in economic terms, are, nevertheless, of significant  
9 value to customers. It is PPL Electric's firm belief that customers are better off  
10 for having the AMR system.

11 **Proposals to Promote Retail Competition**

12 Q. Please describe the recommendations of Strategic Energy witness Jim  
13 McCormick to promote retail competition.

14 A. Strategic witness McCormick makes five recommendations that he believes will  
15 lead to increased retail competition in PPL Electric's service territory. These are:

- 16 1. Accelerate the enhancement of the AMR system and make data derived  
17 from that system available to Electric Generation Suppliers ("EGSs").
- 18 2. Make available 12 months of usage data to EGS's for customers that have  
19 authorized the release of such data.
- 20 3. Provide an updated of the Eligible Customer list.
- 21 4. PPL Electric should accept an EGS's telephonic representation that the  
22 customer has authorized the EGS to obtain historical usage information.

1 5. PPL Electric should commit to having EGS Consolidated Billing available  
2 within a specified period after an EGS requests it.

3 Q. Are these issues germane to a rate request involving distribution rates?

4 A. Some of the issues are appropriately addressed in a distribution case. For  
5 example, the AMR system is distribution plant so the issue regarding further  
6 enhancement of the AMR system is appropriately addressed here. However, the  
7 issue of making additional metering data available to EGSs is not appropriate to  
8 address because it relates to the generation portion of electric service which  
9 remains capped under the terms of the Restructuring Settlement. Nevertheless,  
10 the Company is prepared to respond to Strategic witness McCormick's individual  
11 points.

12 Q. How do you respond to the request to accelerate enhancements of the AMR  
13 system?

14 A. PPL Electric has stated in its direct case its expectation that the functionality of  
15 its AMR system can be enhanced and that the Company expects to pursue  
16 appropriate enhancements in anticipation of the end of the generation rate cap  
17 on December 31, 2009. The Company is currently an active participant in both  
18 the Commission's Demand-Side Response Working Group and Provider of Last  
19 Resort (POLR) Roundtable – two collaborative efforts wherein future metering  
20 and data requirements will be defined. The Company believes it is important to  
21 work within collaboratives such as these so that the needs of all stakeholders can  
22 be properly recognized in Commission orders and policies. The Company is  
23 concerned about the possibility that it might undertake enhancements that would,

1 in the end, be inconsistent with whatever direction the Commission might  
2 establish.

3 Currently, PPL Electric makes available to EGSs metering information  
4 consistent with its Restructuring Settlement and Commission-approved supplier  
5 tariff. PPL Electric intends to continue providing that information through at least  
6 the term of the Settlement (currently December 31, 2009) consistent with and in  
7 support of the billing, load scheduling, and load reconciliation processes  
8 established in the Restructuring Settlement.

9 PPL Electric does not offer POLR service in competition with EGSs as  
10 suggested by Strategic witness McCormick. POLR service is default service  
11 available, consistent with the Competition Act, to customers who elect not to  
12 seek supply from an EGS and to customers whose EGS fails to provide  
13 contracted for supply. The price that PPL Electric charges for POLR service is  
14 *established by the Restructuring Settlement and cannot change, regardless of*  
15 *the capabilities of AMR, during the term of the Restructuring Settlement.*

16 In summary, PPL Electric is encouraged by the support offered by  
17 Strategic witness McCormick for the Company's AMR system and for further  
18 development of that system, but believes that there is no need for an accelerated  
19 development and that such a development might, in fact, result in unnecessary  
20 and inappropriate expenditures.

21 Q. How do you respond to the request that PPL Electric make available 12 months  
22 of usage data to EGS's for customers that have authorized the release of such  
23 data?

1 A. PPL Electric currently does provide EGSs with twelve (12) months of usage and  
2 demand data for customers who have agreed to allow EGS's access to their  
3 account data. For customers that are billed using non-interval meters, 24 data  
4 points are sent per request. There are twelve (12) usage and twelve (12)  
5 demand data points sent per request. For customers that are billed using interval  
6 meters, one year of hourly data is sent per request. PPL Electric's standard  
7 method of providing historical usage data to EGSs is through standardized  
8 electronic data transactions called Electronic Data Interchange (EDI)  
9 transactions. These EDI transactions are exchanged between the EGS and PPL  
10 Electric according to standards established by the Commission's Electronic Data  
11 Exchange Working Group (EDEWG). EGS's sends an EDI 814 historical usage  
12 (HU) request to PPL Electric. The Company sends back to the supplier an EDI  
13 814 HU response that PPL Electric either accepted or rejected the EGSs  
14 historical usage request. Requests may be rejected because they don't match  
15 an active customer account number or because the customer has indicated that  
16 his usage information is not to be made available. When PPL Electric accepts  
17 the EDI 814 HU, the Company sends the EGS an EDI 867 HU transaction that  
18 contains the customer usage and demand information.

19 Q. How do you respond to the request that PPL Electric send "opt-out" cards to  
20 customers biannually (or at some other regular interval) in order to update its  
21 Eligible Customer list?

22 A. During the pilot-program and phase-in of customer choice, the number of  
23 customers eligible to participate was limited and EGSs had a need to know which

1 specific customers were participating so they could market to those customers.  
2 Orders implementing pilot programs and restructuring orders required utilities to  
3 establish and maintain Eligible Customer Lists to address this need. PPL Electric  
4 established such a list and maintained it through the completion of the phase-in,  
5 which for PPL Electric was January 2, 2000. As of that date, all customers were  
6 eligible for choice and there was no longer a need to identify eligible customers  
7 separate from ineligible customers. PPL Electric still solicits information from  
8 new customers for the purpose of responding to 814 HU requests (such as the  
9 customer's willingness to release its usage to EGSs). However, PPL Electric no  
10 longer maintains the Eligible Customer List.

11 Strategic witness McCormick recommends the periodic dissemination  
12 of "opt-out" cards which were the mechanism by which existing customers  
13 indicated whether they wished to withhold information from the Eligible Customer  
14 List. Given that the need addressed by the Eligible Customer List no longer  
15 exists and that the list is no longer maintained, the sending of "opt-out" cards is  
16 unnecessary. Witness McCormick may, instead, be pointing to another need –  
17 that being the desire of EGSs to have customer usage information to identify the  
18 customers that can be served most profitably and to develop proposals for those  
19 customers. Because the Eligible Customer List included historical usage  
20 information, for those customers willing to allow it to be published, EGSs came to  
21 rely on the List for that information. However, EDEWEG rules established the  
22 historical usage request process described above as a more efficient and lower  
23 cost means by which EGSs could obtain customer usage information. PPL

1 Electric assumes that the remaining issue in this regard is an individual  
2 customer's willingness to make his usage information available. PPL Electric has  
3 established Web-based procedures to address this issue that it believes are  
4 more appropriate and less costly than the option of periodically sending 1.3  
5 million post cards to customers asking them if their prior election regarding  
6 confidentiality has changed.

7 Q. How do you respond to the request that PPL Electric should accept an EGS's  
8 telephonic representation that the customer has authorized the EGS to obtain  
9 historical usage information?

10 A. Customers' right to privacy and the confidentiality of customer information are  
11 important issues that are recognized by PPL Electric and the Commission. The  
12 Commission went to great lengths to establish rules regarding customer choice  
13 that attempted to protect customer rights while providing EGSs reasonable  
14 opportunities to bring potentially beneficial proposals to customers. An additional  
15 and important concern that the Commission was attempting to address through  
16 these rules was that the availability of customer information could facilitate  
17 slamming. In this regard, PPL Electric is reluctant to accept a telephonic  
18 representation by an EGS because the customer's intent cannot be verified.

19 Aside from choice, PPL Electric has a standing practice of requiring  
20 the use of verifiable means to evidence a customer's desire to have its usage  
21 information provided to any third party. PPL Electric, responding to the concerns  
22 of a significant number of customers, is concerned that consultant's may  
23 represent that they have the customer's approval to obtain usage information

1 when, in fact, they are acting in their own interest or in the interest of a client that  
2 may be a competitor of the customer. That practice in the past required the use  
3 of customer letterhead but has been since updated to accept e-mail with  
4 appropriate safeguards. These practices have never included the acceptance of  
5 telephonic requests.

6 Q. How do you respond to the request that PPL Electric should commit to having  
7 EGS Consolidated Billing available within a specified period after an EGS  
8 requests it?

9 A. At the start of the phase in of competition in 1999, PPL Electric was replacing its  
10 customer information and billing system because the existing system was not  
11 Y2K-compliant and because it could not be cost effectively modified to  
12 accommodate the functionality necessitated by customer choice. In part  
13 because the choice rules were not finalized until late in the system's design, PPL  
14 Electric experienced a number of billing problems in early 1999 with choice  
15 accounts. There was also some functionality that simply was not available at the  
16 outset. One functionality that was not available was the ability to support EGS  
17 Consolidated Billing. The Company worked closely with the Commission's Office  
18 of the Executive Director during 1999 and 2000 as the Company corrected the  
19 problems and deficiencies. As part of that effort it was agreed that, as long as no  
20 EGSs were seeking to perform EGS Consolidated Billing, providing that  
21 functionality could be a lower priority. It was agreed that if an EGS made known  
22 that it wished to employee that functionality, PPL Electric would work with the  
23 EGS to (1) identify interim alternatives, and (2) design and install the

1 modifications necessary to support that functionality. While no EGS has  
2 indicated a need for EGS Consolidated Billing, PPL Electric has done much of  
3 the design work and has completed some of the necessary modifications. The  
4 Company estimates that of the originally estimated 6.700 manhours of work,  
5 about 3.000 manhours of work remain. PPL Electric estimates that it will require  
6 about ten months to complete the remaining work and test the modifications.  
7 Because the necessary modifications affect the fundamental structure of the  
8 customer support system and because they are so extensive, PPL Electric  
9 anticipates that other system enhancements, including ones that may be  
10 beneficial to customers, be placed on hold during the period in which EGS  
11 Consolidated Billing modifications are being made.

12 Strategic witness McCormick's comments don't indicate a need for  
13 this functionality, only that it works in Texas where customers appear, unlike in  
14 Pennsylvania, to have no option regarding bill presentment. PPL Electric stands  
15 by its original commitment to complete EGS Consolidated Billing upon a  
16 reasonable demonstration that ratepayer money would be spent on functionality  
17 that would be useful to customers. PPL Electric also is prepared to work with  
18 any EGS to explore lower cost alternatives that may be available to achieve an  
19 equivalent functionality.

20 Q. Does this conclude your rebuttal testimony?

21 A. Yes, it does.

# PPL Electric Utilities 2004 Transmission Related Charges Forecast

2004  
Forecast

	OATT Attachments	Basis Description	Basis Value	Rate (Note 3)	Forecast Charge (+)/Credit (-)	Notes
<b>Network Transmission Service</b>						
Payment to PJM for PPL EU LSE Non Shopping Retail Customers	H-8	PPL EU Network Transmission Service Peak Load Responsibility (PLR)	2,252,366 MWD	52.2274 \$/MWD	\$117,635,232	1
Payment to E+ for PPL EU Call Option	Power Supply Agreement	Call Option (400 MW)	148,400 MWD	52.2274 \$/MWD	\$7,646,091	1, 2
<b>Net Network Transmission Service Charge</b>					<b>\$125,281,324</b>	
<b>Ancillaries</b>						
	OATT Schedule (Note 6)					
PJM System Control and Dispatch Service	1, 9	Real Time Net POLR Load	33,448,008 MWH	0.406 \$/MWH	\$13,579,891	5, 10
Transmission Owner Scheduling, System Control and Dispatch Service	1A	Real Time Net POLR Load	33,448,008 MWH	0.0618 \$/MWH	\$2,067,987	7
Reactive Supply and Voltage Control from Generation Sources Service	2	PPL EU Network Transmission Service PLR (PPL Share of Zone PLR)	2,252,366 MWD	5.4637 \$/MWD	\$12,306,363	4
Black Start Service	5A	PPL EU Network Transmission Service PLR	2,252,366 MWH	0.0650 \$/MWD	\$146,340	
Regulation and Frequency Response Service	3	Average Daily Regulation Obligation	42.67 MW	44.61 \$/MWH	\$1,870,420	8
Operating Reserve - Supplemental Reserve Service						
Day Ahead	6	Day Ahead Net POLR Load Forecast	34,841,675 MWH	0.1975 \$/MWH	\$6,881,231	
Real Time (Balancing)	6	Absolute Value of Real Time Net POLR Load less Day Ahead Net POLR Load Forecast	1,916,292 MWH	1.1646 \$/MWH	\$2,231,714	
Operating Reserve - Spinning Reserve Service	5	Real Time Net POLR Load	33,448,008 MWH	0.2033 \$/MWH	\$6,799,980	9
MAAC	10	Real Time Net POLR Load	33,448,008 MWH	0.0100 \$/MWH	\$334,480	
PJM West Transition Charge	11	Real Time Net POLR Load	33,448,008 MWH	0.0381 \$/MWH	\$1,274,369	4
PJM Membership		Annual Charge per Member	1 Membership	5000 \$/Membership	\$5,000	
<b>Net Network Transmission Service Charge</b>					<b>\$125,281,324</b>	
<b>Total Ancillary Service Charge</b>					<b>\$62,346,876</b>	
<b>Total Transmission Cost</b>					<b>\$187,628,198</b>	
Adjusted for GRT (5.9%)					\$199,392,348 \$0.00556 / KWH	
PRS and Ralston					(\$60,001)	
Less: Steelton					(\$358,668)	
<b>Transmission Costs to Be Recovered</b>					<b>\$198,973,679 \$0.00564 / KWH</b>	

**Notes**

- OATT Attachment H-8 - Network Integration transmission Service is \$19063/MW-Year = 52.2274/MW-Day
- The Power Supply Agreement with PPL EnergyPlus makes requires EnergyPlus to pay for all ancillary charges associated with the "Call Option" but PPL Electric Utilities is responsible for the Network Transmission Service cost. PJM charge EnergyPlus for all cost and Electric Utilities then reimburse EnergyPlus for the Network Transmission Cost.
- Rates based on 2003 level unless otherwise noted.
- PPL EU Share of the Network Transmission Service Peak Load Responsibility in the PPL Zone time the Monthly Carrying Charges of the Zone Reactive Supply Units as specified in the OATT Schedule 2
- PJM System Control, and Dispatch Service (OATT Schedule 1) are unbundled in (Schedule 9). It include Control Area , Capacity Adequacy, Market Support, Regulation and Frequency Response, Internal Energy Transaction, and Capacity Resource and Obligation Administration. These charges are based on the PJM projected rates including the Transmission Market Expansion Charges for Commonwealth Edison joining PJM.
- OATT Schedules effective for 2004
- Rate approved by FERC in the OATT effective in 2002.
- PJM West Transition Charge as currently defined for Allegheny Electric is to end when Transitional Market Expansion Charge (Schedule 11) and the Revenue Neutrality Charges (Schedules 7, 8) equal \$84,993,360. This is anticipated to occur near the end of 2004.
- Market Based Pricing
- If Commonwealth Edison Joins PJM in November of 2003 the Transmission Market Expansion Charges PPL would incur are projected to be approximately equal to the reduction in Schedule 9 charges resulting in a net zero effect on PPL EU.

## Relative Transmission Rates 2004 Forecast Loads

Peak Load Responsibilities based on 2003 Winter Peak

	Rate (\$/KWH)	Deviation from Avg.
IST	\$0.00389	(\$0.00169)
LP6	\$0.00393	(\$0.00165)
LP5	\$0.00455	(\$0.00103)
ISP	\$0.00456	(\$0.00102)
LP4	\$0.00459	(\$0.00099)
GS3	\$0.00470	(\$0.00088)
LPEP	\$0.00490	(\$0.00068)
ISM	\$0.00492	(\$0.00066)
GS1	\$0.00541	(\$0.00017)
STL	\$0.00604	\$0.00046
IS1	\$0.00667	\$0.00109
GRS, EXR, BL	\$0.00712	\$0.00154
GH	\$0.00765	\$0.00207
RTS	\$0.01097	\$0.00539
Total	\$0.00558	
Industrial	\$0.00445	(\$0.00113)
Commercial	\$0.00495	(\$0.00063)
Residential	\$0.00723	\$0.00166

## Relative Transmission Rates 2003 Loads

Peak Load Responsibilities based on 2002 Summer Peak

	Rate (\$/KWH)	Deviation from Avg.
STL	\$0.00161	(\$0.00423)
LPEP	\$0.00205	(\$0.00379)
IS1	\$0.00336	(\$0.00248)
ISM	\$0.00360	(\$0.00223)
RTS	\$0.00421	(\$0.00163)
IST	\$0.00441	(\$0.00143)
LP5	\$0.00533	(\$0.00051)
LP4	\$0.00538	(\$0.00046)
ISP	\$0.00541	(\$0.00043)
LP6	\$0.00553	(\$0.00031)
GH	\$0.00590	\$0.00006
GRS, EXR, BL	\$0.00597	\$0.00013
GS3	\$0.00640	\$0.00056
GS1	\$0.00727	\$0.00144
 Total	 \$0.00584	
 Industrial	 \$0.00517	 (\$0.00067)
Residential	\$0.00591	\$0.00008
Commercial	\$0.00649	\$0.00065

**DOCUMENT**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-00049255**

**DOCKETED**

**JUL 28 2004**

**PPL Electric Utilities Corporation**

**Statement No. 5-R**

**Rebuttal Testimony of Joseph M. Kleha**

1 **Rebuttal Testimony of Joseph M. Kleha**

2 Q. Please state your name and business address.

3 A. My name is Joseph M. Kleha. My business address is PPL Services  
4 Corporation, Two North Ninth Street, Allentown, Pennsylvania, 18101.

5  
6 Q. Did you previously submit direct testimony in this proceeding on behalf of PPL  
7 Electric Utilities Corporation?

8 A. Yes. I submitted my direct testimony, Statement No. 5, on March 29, 2004.

9  
10 Q. What is the purpose of your rebuttal testimony?

11 A. My rebuttal testimony responds to the assertions of witnesses on behalf of the  
12 various intervenors on the following topics:

13 (1) the appropriate cost allocation methodology to be used in this proceeding,  
14 including alternatives to PPL Electric's preferred maximum NCP demand  
15 allocation method (responding to Mr. Galligan);

16 (2) the use of the minimum size system study to determine the applicable  
17 customer cost component (responding to Messrs. Galligan and Knecht);

18 (3) the exclusion of one-half of future test year plant additions from rate base  
19 (responding to Mr. Prisco);

20 (4) a reduction in cash working capital due to a change in net lag days  
21 (responding to Messrs. Weakley and Morgan);

22 (5) the exclusion from rate base of prepaid postage (responding to Mr.  
23 Morgan);

- 1 (6) an increase in customer deposits to reflect growth from 2003 to 2004  
2 (responding to Mr. Morgan);
- 3 (7) the inclusion of unbilled revenue in future test year operating revenue  
4 (responding to Mr. Prisco);
- 5 (8) the calculation of future test year capital stock tax expense (responding to  
6 Messrs. Weakley and Morgan);
- 7 (9) the allocation of uncollectible accounts expense to energy and capacity  
8 rates (responding to Mr. McCormick); and
- 9 (10) the consideration of generation-related property tax appeals in this  
10 proceeding (responding to Mr. Epstein).

11

12 I. Cost Allocation Principles and the NCP Demand Allocation Methodology

13 Q. Mr. Kleha, do you have any general comments regarding the various cost  
14 allocation proposals made by other parties in this proceeding?

15 A. Yes. First, when considering the appropriateness of a utility's proposed cost  
16 allocation methodology, cost allocation must be recognized for what it is – an art,  
17 not an exact science. There is no single, absolutely correct method. Moreover,  
18 as the Commission has repeatedly recognized, a cost allocation study serves  
19 only as a guide and is just one of several important factors to be considered  
20 when designing a utility's rates.

21 Second, other parties in this proceeding offer a variety of criticisms of PPL  
22 Electric's cost allocation study. The one consistency among them, however, is  
23 that they all propose changes which, if adopted, would place their respective

1 clients in a more advantageous position. The Company, however, lacks the  
2 incentive to favor one customer class over another when assigning costs. PPL  
3 Electric has attempted to take a reasonable middle-of-the-road position regarding  
4 the allocation of costs to the various customer classes. Of particular note is the  
5 fact that the Office of Trial Staff, the only other party not associated with a  
6 particular customer class, has not challenged or criticized the Company's cost  
7 allocation study.

8 Third, consistency is an important factor in cost allocation. There are  
9 obviously many different methods of cost allocation, but PPL Electric has used  
10 the same approach for many years, and that approach has been consistently  
11 approved by the Commission in prior PPL Electric rate proceedings. Changing  
12 methods, without a compelling reason, is not appropriate in my opinion.

13 Fourth, a significant change in methodology in this case would be  
14 particularly inappropriate. PPL Electric's current rate structure is a product of the  
15 rate unbundling process which occurred in its electric restructuring proceeding.  
16 The unbundling of rates in that proceeding was based on the cost allocation  
17 study from PPL Electric's 1995 base rate proceeding which reflects the  
18 Company's operation as a vertically integrated electric company. Thus, PPL  
19 Electric's current rate structure contains vestiges of its prior vertical integration.  
20 The rate cap on PPL Electric's transmission and distribution rates ends on  
21 December 31, 2004, but the cap on generation rates extends through 2009. It  
22 would be inappropriate, in my view, to undertake a major revision to PPL

1 Electric's cost allocation procedures in these circumstances. Any such review  
2 should await the expiration of the cap on generation rates.

3 Finally, although the opposing parties have raised some interesting  
4 theoretical issues regarding cost allocation techniques, those issues have only  
5 limited relevance in this proceeding. The central issue to be considered is  
6 whether PPL Electric's proposed allocation of the revenue increase and its rate  
7 design are reasonable.

## 8 9 II. Demand Allocation Methodology

10 Q. Please describe PPL Electric's allocation of the costs associated with its  
11 distribution-related facilities.

12 A. PPL Electric's allocation of the costs associated with its distribution-related  
13 facilities generally adheres to the guidelines set forth in the NARUC Electric  
14 Utility Cost Allocation Manual. The NARUC Manual states that an electric utility's  
15 distribution-related facilities are, from a design and operational basis, sized to  
16 meet the maximum load (demand) requirements of customers. As a result, PPL  
17 Electric believes that the maximum non-coincident peak ("NCP") demand  
18 allocation methodology is the most appropriate method for allocating the costs of  
19 its distribution-related facilities. It should be noted that PPL Electric historically  
20 has used, and this Commission has accepted, the use of the maximum NCP  
21 demand method to allocate the costs associated with the distribution-related  
22 facilities reflected in all of its previous base rate cases.

1 Q. Do you agree with Mr. Galligan's proposed use of a peak and average demand  
2 allocation methodology to allocate the costs associated with distribution-related  
3 facilities?

4 A. No, I do not. The use of the peak and average demand allocation method would  
5 allocate the costs associated with distribution-related facilities partially on the  
6 basis of the load (demand) imposed on the distribution system by customers, and  
7 partially on the basis of energy consumed by customers. The allocation of the  
8 costs associated with distribution-related facilities in this manner is inappropriate  
9 for the following two reasons.

10 First, as the NARUC Manual succinctly states, there is no energy  
11 component of distribution-related facilities (and expenses), only the demand and  
12 customer components.

13 Second, distribution facilities do not vary based on the amount of energy  
14 consumed by customers, rather, distribution facilities are sized to meet the peak  
15 load (demand) requirements of customers, and increase in size only when the  
16 peak load requirements imposed on those facilities outgrows the capability of the  
17 facilities.

18 As a result, the peak and average method does not, in my opinion,  
19 properly recognize cost causation when it is used to allocate the costs associated  
20 with an electric utility's distribution-related facilities.

1 III. Use of a Minimum Size System Study

2 Q. Have you reviewed Mr. Galligan's criticism of PPL Electric's use of a minimum  
3 size system study to determine those costs to be classified as customer-related?

4 A. Yes, I have. Mr. Galligan criticizes PPL Electric because its minimum size  
5 distribution system study is based on the smallest size equipment currently being  
6 installed on its system, and because the smallest size of certain individual  
7 components of that equipment have changed over time. He also criticizes PPL  
8 Electric's method stating that it results in higher cost attribution than would result  
9 from using a different method. However, although he apparently supports the  
10 use of a "zero intercept" method, he has not offered the results of that method or  
11 any other method to support his position.

12  
13 Q. Do you agree with this criticism?

14 A. No, I do not. PPL Electric has followed the NARUC Cost Allocation Manual that  
15 defines a minimum size distribution system based on the smallest size  
16 equipment currently being installed by the utility. As such, it is clearly recognized  
17 that the size of individual components of the minimum size system will change as  
18 the load imposed by customers on an electric utility's distribution-related facilities  
19 increases over time.

20  
21 Q. Messrs. Galligan and Knecht suggest that the zero intercept method is better  
22 than the minimum size system method. Is this suggestion realistic?

1 A. No. The Company has investigated the use of the zero intercept method and  
2 found this method impractical, given the available data in its accounting records.  
3 As Messrs. Galligan and Knecht recognize, this method has inherent problems  
4 namely the lack of necessary data. Even if the necessary data were available,  
5 the zero intercept method is complex and inherently arbitrary. PPL Electric's last  
6 review of this method produced negative zero intercept cost results for wood  
7 poles, copper conductors and aluminum conductors. Therefore, the zero  
8 intercept method obviously is not an accurate or reasonable approach for PPL  
9 Electric.

10  
11 Q. Have you reviewed Messrs. Galligan and Knecht's proposals regarding  
12 adjustment of the Company's demand allocators because its minimum size  
13 equipment has some load-carrying capability?

14 A. Yes, I have.

15  
16 Q. Do you agree with these proposals?

17 A. No. Both witnesses propose to adjust the Company's demand allocators  
18 because the equipment used in its minimum size system study has some load-  
19 carrying capability. These proposals are flawed for several reasons.

20 First, a minimum size distribution system, by definition, must have some  
21 load-carrying capability. The fact that the Company's minimum system has some  
22 load carrying capability provides no basis for rejecting it.

1           Second, demand is a function of the load imposed on an electric utility's  
2 system by its customers and this demand, and the allocators derived from it, are  
3 unaffected by a "hypothetical" minimum size system study.

4           Third, PPL Electric has allocated its primary voltage-related distribution  
5 system costs solely on the basis of demand even though the primary voltage  
6 system undoubtedly has a customer-related cost component which could offset  
7 any perceived overstatement of the customer-related cost component associated  
8 with the secondary voltage-related distribution system.

9           Finally, this Commission rejected a similar proposal in PPL Electric's last  
10 base rate proceeding at Docket No. R-00943271.

11  
12 Q.   Do you have any further comments on the minimum size system issue?

13 A.   My specific critique of the opposing party arguments is set forth above. More  
14 importantly, the selective criticism offered by these witnesses misses the point.  
15 All aspects of any cost allocation study are based on judgment. The entire  
16 purpose of a cost allocation study is to "allocate" costs which cannot be directly  
17 assigned. Reasonable people can differ as to the basis for allocating all of the  
18 costs in a cost allocation study. However, it is unfair, in my view, to focus on only  
19 one aspect of cost allocation, criticize it, and adjust it, without concurrently doing  
20 the same for all other aspects of the study.

21           For example, Mr. Galligan extensively critiques PPL Electric's allocation of  
22 secondary distribution system costs – contending that the Company has  
23 overstated the customer component and understated the demand component.

1 Yet, he ignores the fact that PPL Electric's primary distribution plant costs are  
2 allocated 100% on a demand basis and 0% on a customer basis. Valid  
3 arguments can be made that some portion of primary distribution system costs  
4 should be allocated on a customer basis. In my view, any minor overstatement  
5 of the customer cost component of the secondary distribution system under the  
6 Company's minimum size system method would be, at least partially, offset by  
7 the allocation of all primary distribution system costs on a demand basis. For  
8 these reasons, it is my opinion that on an overall basis PPL Electric's allocation  
9 of its distribution system costs, both primary and secondary, is both fair and  
10 reasonable.

#### 11 12 IV. Future Test Year Plant Additions

13 Q. Have you reviewed Mr. Prisco's testimony regarding the Company's future test  
14 year plant in service claim?

15 A. Yes, I have. Mr. Prisco proposes to arbitrarily exclude \$64,684,000 from PPL  
16 Electric's future test year plant in service claim on the basis that only one-half the  
17 new additions will be used and useful.

18  
19 Q. Do you agree with Mr. Prisco's proposed reduction to plant in service?

20 A. Absolutely not. Mr. Prisco's proposal is without merit and should be rejected for  
21 the following reasons.

22 First, utility ratemaking in Pennsylvania is based on test year data as of  
23 the end of the claimed test year. In this proceeding, the end of the claimed test

1 year is December 31, 2004. As such, all components of rate base are  
2 determined as of this date. Operating revenues and expenses are determined  
3 for the full 12-month period ending December 31, 2004. Consequently, any rate  
4 base additions that are projected to be placed in service on or before the last day  
5 of the test year are presumed to be in service during the test year.

6 Second, because the claimed future test year in this proceeding will end  
7 on December 31, 2004 and new rates will become effective on January 1, 2005,  
8 those prospective rates should be based on fully annualized and normalized test  
9 year data, including all plant additions.

10 Finally, the Commission's regulations at Section 69.371(a)(4) permit an  
11 electric utility to make a claim for construction work in progress ("CWIP"). This  
12 Commission has granted rate base treatment for plant additions included in  
13 CWIP, if the facilities associated with that CWIP are expected to be placed in  
14 service no later than 6 months after the end of the claimed test year.

15  
16 V. Cash Working Capital

17 Q. Have you reviewed Messrs. Weakley's and Morgan's testimony regarding the  
18 Company's claim for cash working capital?

19 A. Yes, I have. Messrs. Weakley and Morgan propose to reduce PPL Electric's  
20 claim for cash working capital due to an incorrect date assigned to an invoice for  
21 the delivery of sulfur hexafluoride gas.

22  
23 Q. Do you agree with Messrs. Weakley's and Morgan's proposal?

1 A. Yes, I do. In the lead/lag study prepared by the Company in this proceeding, the  
2 invoice for the delivery of sulfur hexafluoride gas was inadvertently assigned a  
3 negative 85 days lag, rather than the actual 311 days lag. When the actual lag  
4 days are used, the average lag in days between the payment of O&M expenses  
5 and the receipt of revenue, as shown on Schedule C-4, page 2, of Exhibit Future  
6 1, declines from 13.4 days to 12.9 days. This change in the net lag days reduces  
7 PPL Electric's cash working capital claim for its combined T&D operations by  
8 \$522,000, or \$389,000, on a PUC-jurisdictional distribution-only operations basis.  
9 The effect of this correction to cash working capital is shown on Schedule C-4,  
10 pages 1 and 2, of Revised Exhibit Future 1.  
11

12 VI. Prepayments

13 Q. Have you reviewed Mr. Morgan's testimony regarding the Company's claim for  
14 prepaid postage?

15 A. Yes, I have. Mr. Morgan proposes to exclude prepaid postage from the  
16 Company's claimed level of prepayments included in its rate base, because  
17 postage expenses also are reflected in the Company's lead/lag study.  
18

19 Q. Do you agree with Mr. Morgan's proposal?

20 A. No, I do not. As Mr. Morgan clearly recognizes, PPL Electric is entitled to earn a  
21 return on cash outflows (prepayments) prior to the time that the items for which  
22 the prepayment was incurred are used and recorded as an O&M expense, but  
23 would deny the Company this return because postage expenses also are

1 reflected in its lead/lag study. This proposal is inappropriate because it fails to  
2 reflect the fact that the two claims arise from two different time periods. The  
3 prepayment claim reflects the difference between the time PPL Electric prepays  
4 for postage and records it as an O&M expense. The cash working capital claim  
5 for postage reflects the difference between when the Company records postage  
6 as an O&M expense and when it recovers revenue from customers for that  
7 expense. Consequently, there is no double-recovery of a return on prepaid  
8 postage, as Mr. Morgan suggests.

9  
10 VII. Customer Deposits

11 Q. Have you reviewed Mr. Morgan's testimony regarding the level of customer  
12 deposits reflected in the Company's claimed rate base?

13 A. Yes, I have. Mr. Morgan proposes to increase the level of customer deposits  
14 reflected in the Company's claimed rate base. He makes this proposal because  
15 the Company did not escalate the level of customer deposits for the 2004 future  
16 test year over the amount recorded on its balance sheet at December 31, 2003.  
17 Mr. Morgan also proposes a related increase to the interest expense associated  
18 with customer deposits.

19  
20 Q. Do you agree with Mr. Morgan's proposal?

21 A. Conceptually, I agree with Mr. Morgan's proposal. However, his proposed  
22 escalation rate of approximately 32% is excessive. During the period January 1,  
23 2004 through June 30, 2004, the level of customer deposits increased by 12.95%

1 over the ending balance at December 31, 2003. Based on this rate of escalation  
2 for the first 6 months of 2004, PPL Electric would expect the same rate of growth  
3 in customer deposits for the next 6 months of 2004, or an overall annual growth  
4 rate of 27.6%. As a result, the level of customer deposits to be reflected in the  
5 Company's claimed rate base at December 31, 2004 would be \$20,463,000, or  
6 an increase of \$4,424,000. This increase in the level of customer deposits is  
7 shown on Schedule C-4, page 1, of Revised Exhibit Future 1. The related  
8 increase in interest expense associated with customer deposits of \$57,000 is  
9 shown on Schedule D-7 of Revised Exhibit Future 1.

10  
11 VIII. Unbilled Revenue

12 Q. Have you reviewed Mr. Prisco's testimony regarding the Company's adjustment  
13 to eliminate unbilled revenue from its claimed future test year operating revenue?

14 A. Yes, I have. Mr. Prisco proposes to reverse PPL Electric's adjustment to  
15 eliminate unbilled revenue in the amount of \$2,395,000 from its claimed future  
16 test year operating revenue. This proposal is based on his belief that the  
17 elimination of unbilled revenue creates a mismatch between revenues and  
18 expenses.

19  
20 Q. Is Mr. Prisco correct regarding the elimination of unbilled revenue?

21 A. No, he is not. To the contrary, his proposal to include unbilled revenue would  
22 create the mismatch of revenues and expenses he seeks to avoid.

1 Q. Please explain.

2 A. Operating revenue is recorded based on energy deliveries through the end of  
3 each calendar month. Unbilled retail revenue results because customers' meters  
4 are read and bills are rendered throughout the month, rather than all meters  
5 being read at the end of the month. Unbilled revenue is recorded each month  
6 throughout the year, and the net amount of unbilled revenue for a calendar year  
7 is the difference between the amount for December of the current year and  
8 December of the prior year. The difference arises primarily from differences in  
9 weather and changes in number of customers or changes in usage by existing  
10 customers. In this proceeding, unbilled revenue amounts to \$2,395,000 for the  
11 future test year ending December 31, 2004, as shown on Schedule D-3 of Exhibit  
12 Future 1.

13 For ratemaking purposes, unbilled revenue must be excluded from the test  
14 year level of operating revenue to avoid a double-counting of sales revenue for  
15 the test year. This double-count would occur because PPL Electric budgets  
16 revenue based on normal weather conditions and annualizes the test year level  
17 of revenue derived from sales to customers to account for changes in the number  
18 of customers in the test year and changes in customers' usage for the full 12  
19 months of the test year. As a result, Mr. Prisco's proposed inclusion of unbilled  
20 revenue, in conjunction with PPL Electric sales annualization adjustment, would  
21 create an overstatement of future test year operating revenue and a mismatch  
22 with test year operating expenses.

23

IX. Capital Stock Tax

1

2 Q. Have you reviewed the testimony of Mr. Weakley regarding the Company's claim  
3 for capital stock tax expense?

4 A. Yes, I have.

5

6 Q. Do you agree with Mr. Weakley's proposals regarding capital stock tax?

7 A. No, I do not. Mr. Weakley proposes to modify PPL Electric's claim for capital  
8 stock tax expense by: adjusting the net income calculation for the 2004 tax year  
9 by excluding net income data for the 2000 tax year, including net income data for  
10 the 2005 tax year, and decreasing the capital stock tax rate for 2004 from 6.99  
11 mills to 5.99 mills.

12

13 Q. Why does Mr. Weakley exclude the net income data for the 2000 tax year?

14 A. He excludes net income data for the 2000 tax year because the data includes net  
15 income from PPL Electric's former generation operations for the period,  
16 January 1 through June 30, 2000. Effective July 1, 2000, all generation assets  
17 were transferred to an affiliate company.

18

19 Q. Is this exclusion 2000 net income data appropriate?

20 A. No. Mr. Weakley's proposal to exclude net income data for the 2000 tax year is  
21 contrary to the calculation used by the Pennsylvania Department of Revenue  
22 ("Revenue") to determine a taxpayer's capital stock tax liability. Pursuant to  
23 Sections 602(a) and (b) of the Act of March 4, 1971, P.L. 6 (72 P.S. 7602(a) and

1 (b)), a taxpayer's capital stock tax liability is based on the taxpayer's average net  
2 income for the most recent 5 tax years, including the current tax year, divided by  
3 the taxpayer's net worth at the end of the current tax year. This calculation is  
4 made without regard to whether or not a taxpayer's operations changed in any  
5 manner at any time within the 5-year period. As a result, PPL Electric's actual  
6 2004 capital stock tax liability will be based on its net income for the 5-year  
7 period, 2000 through 2004. Therefore, Mr. Weakley's proposal is inconsistent  
8 with the Department of Revenue's calculation of the actual taxes PPL Electric will  
9 be required to pay for the 2004 tax year.

10  
11 Q. Is it appropriate to include net income data for the 2005 tax year in the  
12 calculation of the Company's 2004 capital stock tax liability?

13 A. No, it is not. As I previously discussed, the calculation of a taxpayer's capital  
14 stock tax liability is based on the average net income for the most recent 5-year  
15 period, including the current tax year. To include, as Mr. Weakley has done, the  
16 net income for the 2005 tax year in the calculation of PPL Electric's 2004 capital  
17 stock tax liability is inconsistent with the Department of Revenue's calculation of  
18 PPL Electric's actual tax liability.

19 Moreover, Mr. Weakley's use of 2005 data causes an error in the  
20 calculation of capital stock tax liability at present rates. This error occurs  
21 because his capital stock tax data for 2005 includes the effect of the rate  
22 increase proposed in this proceeding. It is obviously inappropriate to include the

1 incremental capital stock tax liability caused by the proposed rate increase as  
2 part of the determination of the Company's tax liability under present rates.

3 In addition, contrary to Mr. Weakley's assertion that the amount of the rate  
4 increase granted by the Commission would be an increase to book net income in  
5 the current year (2004), any increase granted by the Commission will become  
6 effective on January 1, 2005, and will be reflected in PPL Electric's net income  
7 for the 2005 tax year. Moreover, if the Commission were to grant PPL Electric  
8 the full amount of its proposed rate increase, the incremental capital stock tax  
9 liability using Revenue's calculation would be \$660,000, as shown on Exhibit  
10 JMK5, not one-tenth of this amount, as Mr. Weakley suggests.

11 The more appropriate approach, and the one PPL Electric has used,  
12 without objection, in all prior rate proceedings, is to first present its tax liability,  
13 including capital stock tax liability, at present rates, and then "gross-up" tax  
14 expense to reflect the effect of the proposed rate increase. Mr. Weakley's  
15 attempt to accomplish both steps in one calculation is confusing, and in this  
16 instance, erroneous. It also is inconsistent with PPL Electric's and Mr. Weakley's  
17 approach for all other taxes.

18  
19 Q. Mr. Weakley proposes to calculate PPL Electric's capital stock tax liability at a  
20 rate 5.99 mills, rather than the current 2004 rate of 6.99 mills. Is this  
21 appropriate?

22 A. No, it is not. The rate of 5.99 mills is the proposed rate to become effective on  
23 January 1, 2005. In its filing, the Company indicated that it would include the

1 difference between the current 2004 rate of 6.99 mills and the proposed 2005  
2 rate of 5.99 mills in its State Tax Adjustment Surcharge ("STAS") filing to be  
3 made on December 21, 2004. The Company proposes to follow this approach  
4 because in each of the two previous years, the Legislature rescinded the  
5 proposed capital stock tax rate decrease at some point during the year, and  
6 increased the applicable capital stock tax rate retroactively to January 1, 2002  
7 and January 1, 2003, respectively. To avoid a potential second increase in  
8 customer rates because of a change in the capital stock tax rate at some point  
9 during 2005, the Company will include the applicable capital stock tax rate in its  
10 STAS mechanism, which was designed specifically for such purposes.

11 *Contrary to Mr. Weakley's assertion, this approach will include any*  
12 *reductions in the capital stock tax liability due to changes in the net income and*  
13 *valuation components of the capital stock tax, because the STAS is based on the*  
14 *most recent settlement of the Company's capital stock value.*

15  
16 Q. Have you reviewed Mr. Morgan's testimony regarding the Company's claim for  
17 capital stock tax expense?

18 A. Yes, I have. Mr. Morgan, like Mr. Weakley, proposes to modify PPL Electric's  
19 claim for capital stock tax expense by: adjusting the net income calculation for  
20 the 2004 tax year by excluding net income data for the 2000 and 2001 tax years,  
21 including net income data for the 2005 tax year, and decreasing the capital stock  
22 tax rate for 2004 from 6.99 mills to 5.99.

1 Q. Do you agree with Mr. Morgan's proposals regarding the calculation of the  
2 Company's 2004 capital stock tax expense?

3 A. No, I do not. For all of the reasons I previously discussed with regard to Mr.  
4 Weakley's proposals, Mr. Morgan's proposals should be rejected.

5  
6 X. Allocation of Uncollectible Accounts Expense to Energy and Capacity Rates

7 Q. Have you reviewed Mr. McCormick's testimony regarding his proposal to allocate  
8 the costs of customer service activities, e.g., uncollectible accounts, to  
9 generation rates?

10 A. Yes, I have. Mr. McCormick proposes to allocate the costs associated with  
11 customer service activities, e.g., uncollectible accounts, to PPL Electric's energy  
12 and capacity rates charged to its POLR customers, because, in his opinion,  
13 these costs are generation related.

14  
15 Q. Do you agree with Mr. McCormick's proposal?

16 A. No, I do not. Mr. McCormick's proposal to allocate the costs associated with  
17 *customer service activities, e.g., uncollectible accounts, to PPL Electric's energy*  
18 *and capacity rates charged to its POLR customer is inappropriate for the*  
19 *following reasons.*

20 First, PPL Electric incurs certain costs, such as, uncollectible accounts, in  
21 its role as an electric distribution company ("EDC"). This role includes the  
22 provision of POLR service, which includes energy and capacity. As such, it is

1 proper to include the cost of uncollectible accounts in the determination of PPL  
2 Electric's distribution function revenue requirements.

3 Second, PPL Electric's rates for energy and capacity (generation supply)  
4 were established in its restructuring proceedings at Docket No. R-00973954,  
5 based on the Commission's determination of the market price of energy and  
6 capacity.

7 Third, the energy and capacity (generation supply) rates, which were  
8 unbundled from the transmission and distribution functions in PPL Electric's  
9 restructuring proceedings, include no cost component for uncollectible accounts.  
10 Rather, uncollectible accounts expense was, and continues to be, reflected in  
11 PPL Electric's unbundled distribution function.

12 Fourth, PPL Electric's energy and capacity (generation supply) rates  
13 should not be artificially increased by some portion of its uncollectible accounts  
14 expense. Rather, the Company's level of uncollectible accounts expense should  
15 be recalculated in a distribution base rate proceeding, such as this one, to reflect  
16 the then-current level of write-offs associated with uncollectible accounts.  
17 Customers shopping for generation supply with an alternative supplier should  
18 pay the supplier's generation supply rates which, presumably, would include that  
19 supplier's level of uncollectible accounts expense. This level, most likely, will be  
20 much lower than that of PPL Electric, because, as an EDC, the Company, unlike  
21 an alternative supplier, has an obligation to serve all customers, regardless of  
22 their payment habits.

1 Finally, if Mr. McCormick's flawed proposal were accepted, PPL Electric  
2 would not have a reasonable opportunity to recover its prudently incurred costs  
3 associated with uncollectible accounts, because its energy and capacity rates are  
4 capped through December 31, 2009.

5  
6 XI. Property Tax Appeals

7 Q. Have you reviewed Mr. Epstein's testimony regarding property tax appeals filed  
8 for the Susquehanna Steam Electric Station and the Brunner Island Steam  
9 Electric Station?

10 A. Yes, I have. Mr. Epstein proposes that the Commission consider the appeals of  
11 certain local property tax assessments associated with the generating facilities  
12 referenced in his testimony when it determines the overall tax liability for PPL  
13 Electric's T&D operations.

14  
15 Q. Do you agree with Mr. Epstein's proposal?

16 A. No, I do not. The appeals of certain local property tax assessments referenced  
17 in Mr. Epstein's testimony relate to generating facilities owned and operated by  
18 an affiliate of PPL Electric and are not reflected in the Company's filing in this  
19 proceeding. PPL Electric's overall 2004 tax liability for its combined T&D  
20 operations is clearly established in Schedules D-12, D-13 and D-14 of Exhibit  
21 Future 1. The Company's 2004 tax liability for its PUC-jurisdictional distribution-  
22 only operations is shown in Exhibit JMK2. No taxes associated with affiliate

1 generating facilities are included therein. Consequently, Mr. Epstein's proposal  
2 on this issue is inappropriate and clearly outside the scope of this proceeding.

3

4 Q. Does this conclude your testimony at this time?

5 A. Yes, it does.

6

## PPL Electric Utilities Corporation

**Revised Estimate of Customer Deposits**  
**As of December 31, 2004**  


---

**(Thousands of Dollars)**

Rate Base		<u>Increase</u>	
Balance at December 31, 2003	\$16,039		
Balance at June 30, 2004	18,117	\$2,078	12.95%
Estimated Balance at December 31, 2004	20,463	<u>2,346</u>	12.95%
Adjustment to Rate Base		<u>\$4,424</u>	<u>27.60%</u>

O&M Expense

Estimated Balance of Customer Deposits at December 31, 2004	\$20,463
Interest Rate	<u>1.28%</u>
Interest on Customer Deposits	262
Less: Claimed Amount <sup>1</sup>	<u>205</u>
Increase in O&M Expense	<u>\$ 57</u>

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<sup>1</sup> Schedule 7 of Exhibit Future 1.

**PPL ELECTRIC UTILITIES CORPORATION**  
**Capital Stock Tax at Present Rates**  
**For the Year Ending December 31, 2004**  
*(Thousands of Dollars)*

<u>Description</u>	<u>Requested Amount</u>	<u>Adjusted Amount</u>	<u>Increase</u>
Net Income			
2000	\$ 277,364	\$ 277,364	
2001	124,282	124,282	
2002	43,633	43,633	
2003	28,470	28,470	
2004 *	45,551	135,713	
	<u>\$ 519,300</u>	<u>\$ 609,462</u>	
Total			
Average	<u>\$ 103,860</u>	<u>\$ 121,892</u>	
Net worth at December 31, 2004	<u>\$ 1,287,339</u>	<u>\$ 1,287,339</u>	
PA Capital stock value	\$ 1,029,384	\$ 1,124,289	
Statutory Exemption	<u>125</u>	<u>125</u>	
Value of Capital Stock less Statutory Exemption	1,029,259	1,124,164	
Apportionment Percentage	<u>0.995148</u>	<u>0.995148</u>	
PA Capital Stock Taxable Value	<u>\$ 1,024,265</u>	<u>\$ 1,118,710</u>	
PA Capital Stock Tax at 6.99 mills	<u>\$ 7,160</u>	<u>\$ 7,820</u>	<u>\$ 660</u>

Note: PA Capital Stock Tax=50%((5 Year Average Net Income/.095)+(75%(Net Worth))

\* 2004 book income increased and net worth increased by \$90,162 to reflect the effect of base rate increase requested.

**DOCUMENT**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-00049255**

**DOCKETED**

**JUL 28 2004**

**PPL ELECTRIC UTILITIES CORPORATION**

**Statement No. 6-R**

**Rebuttal Testimony of Oliver G. Kasper**

1 Q. Please state your full name and business address.

2 A. Oliver G. Kasper, Two North Ninth Street, Allentown, PA 18101.

3

4 Q. Have you previously submitted testimony in this proceeding?

5 A. Yes. I submitted my direct testimony (Statement 6) on March 29, 2004.

6

7 Q. Mr. Kasper, what is the purpose of your testimony?

8 A. The purpose of my testimony is to respond to the direct testimony of witnesses on  
9 behalf of the Office of Consumer Advocate (Mr. Richard Galligan) and the Office of  
10 Trial Staff (Mr. Paul M. Yarolin) regarding the Residential rate designs; to respond to  
11 the witnesses for PLUG (Mr. Joseph V. Link and Mr. John E. Bradley) on unmetered  
12 service for traffic signals; and to respond to the witness for DOD (Mr. Kenneth L.  
13 Kincel) on Tariff Rule 8 – Meter Installations. I also will describe a correction to the  
14 Proposed Tariff for Economic and Industrial Development Initiatives Rider.

15

16 **Tariff Rule 8, Section B – Meter Installations**

17

18 Q. DOD witness Mr. Kincel takes exception to the Company's proposed change in  
19 Tariff Rule 8 - Measurement of Service. Do you have a comment on his  
20 statement?

21 A. Yes. Mr. Kincel does not correctly apply the proposed clarification in Tariff Rule 8.  
22 The proposed change will not affect the billing for the Carlisle Barracks. The two  
23 meters Mr. Kincel refers to are located within the Carlisle Barracks' substation.

1 PPL considers the substation to be one point of delivery. The clarification in Tariff  
2 Rule 8 is intended to address situations in which the meters are not at the same  
3 location. In the Carlisle Barracks situation, this clarification would prevent adding  
4 two meters together that were installed at different locations on the property.  
5

6 **Tariff Rule 8, Section C - Unmetered Service for**  
7 **Traffic Signals**  
8

9 Q. In his testimony PLUG Witness Mr. Joseph V. Link proposes unmetered service for  
10 traffic signals because the electric equipment is "consistent and ascertainable" and  
11 the usage can easily be calculated. Do you agree with Mr. Link's comments?

12 A. No, I do not. The electric equipment for traffic signals can be and is varied,  
13 including "walk/don't walk" signals, audible pedestrian crossing signals, duplex  
14 receptacles and varying number and size of faces on the traffic lights themselves.  
15 In addition, the control cabinets for traffic signals can contain varying components;  
16 such as heaters, lights, and different arrays of control modules to operate the traffic  
17 signal equipment and the sequencing of the equipment at that intersection and, in  
18 some instances, to coordinate with traffic signals at other intersections. Also, I do  
19 not believe the usage can be reasonably calculated. PPL Electric has in the past  
20 looked at the feasibility of unmetered service for traffic signals - most recently  
21 during the conversion to AMR meters. Each time we have looked at the potential  
22 for unmetered service for traffic signals, we have found it impossible to reasonably

1 estimate the usage. Metered intersections with apparently the same equipment  
2 showed differing energy usage.

3  
4 An unmetered service for traffic signals would require an initial analysis of all  
5 equipment at the location. Thereafter, a process would have to be in place for the  
6 customer to notify PPL Electric each time any change in the equipment was made  
7 at a location. The billing would then have to be changed accordingly. If a change  
8 at a location were inadvertently not reported, then the billing would not reflect the  
9 correct usage at that location.

10  
11 There are thousands of traffic light locations in PPL Electric's service territory, each  
12 location having unique energy consumption patterns. If an unmetered program  
13 were put in place, the administration of such a program for the multitude of  
14 locations would place an unreasonable burden on PPL Electric and its customers.  
15 Each intersection can and does have a variety of differences. The existence of  
16 LED lamps is only one of the potential items at any selected street corner. For  
17 example, any combination of the following may be found at a typical intersection:

18  
19 Pedestrian control buttons

20 Street imbedded traffic sensors

21 Duplex receptacles

22 Audible signals for the Blind

23 Fire Department strobe controls

- 1 Radio receivers/transceivers
- 2 Walk/Don't Walk signals
- 3 Turning Arrow Signal Faces
- 4 Timer Controls (Over night flashing, daytime operation)
- 5 Manual Control Interface board
- 6 Control Box moisture and temperature control
- 7 (Heaters and Fans)
- 8 Cameras with motion sensors

9

10 In addition, the number of light faces or size of lamps behind the faces is variable

11 from intersection to intersection and the sequencing of the fixtures can be varied.

12 Below is typical of what can be found at different traffic light locations within PPL

13 Electric's service territory.

14

<b>Location Number</b>	<b>Number of signal faces</b>	<b>Annual kWh</b>	<b>Annual kWh per signal face</b>
1	24	4,858	202
2	24	5,207	217
3	24	3,107	129
4	18	7,081	393
5	35	8,599	246
6	28	8,399	300
7	24	11,486	479
8	47	9,879	210
9	24	5,230	218
10	18	9,115	506
11	37	7,719	209
12	26	15,520	597
13	61	16,162	265

1 Even intersections that appear to have the same equipment (Locations 1, 2, 3, and  
2 9) do not have the same annual energy usage. Frankly, there is no consistency on  
3 the annual kWh per lamp face that would lead to any reliable estimating  
4 procedures for unmetered service for traffic signals.

5  
6 Finally, a metered intersection is in the best interest of the customer. As the  
7 customers change to LED traffic signals, which according to Mr. Link require less  
8 energy, the savings will be directly measured and the anticipated savings will be  
9 reflected on their electric bill.

10  
11 Q. Mr. Link also proposes a separate unmetered rate schedule for traffic signals. Do  
12 you agree with his proposal?

13 A. No, I do not. PPL cannot identify anything unique in the usage characteristics of  
14 traffic signals that would support the creation of a separate rate schedule for them.  
15 In addition, there are no costs that can be directly assigned to traffic signals that  
16 would support a different rate for traffic signals. PPL's objection to an unmetered  
17 rate schedule for traffic signals includes my previous comments on unmetered  
18 *service for traffic signals*.

19  
20 Q. Mr. Bradley's testimony also proposes unmetered service and a separate rate  
21 schedule for traffic signals. Do you have a response?

1 A. His arguments are essentially the same as those presented by Mr. Link. With  
2 regard to these proposals, my response to Mr. Link's proposal also applies to Mr.  
3 Bradley's testimony.

4  
5 In addition, it should be noted that the only cost difference at a new traffic signal  
6 location, between metered and unmetered, would be the cost of the meter base.  
7 *The meter base is located either on the control cabinet (as an integral part of the*  
8 *control cabinet), or just a few inches away on the service drop leading to the*  
9 *control cabinet.*

10 To move to an unmetered tariff for traffic signals from the current metered tariff  
11 would require all the customers to remove the existing meter bases and replace  
12 them with junction boxes to splice the service wires. Under the current National  
13 Electric Code, the meter base cannot be used as a junction box.

14 If only new traffic signal locations were to be unmetered, then a new rate is not  
15 justified for the relatively few locations that would be installed in the future.

16  
17 **Residential (RS) Rate Design**

18  
19 Q. Did you prepare an analysis of the residential rate designs presented in the  
20 testimonies of OCA witness Mr. Richard Galligan and OTS witness Mr. Paul M.  
21 Yarolin?

1 A. Yes I have. My analysis includes some adjustments that were needed to compare  
2 the rate design filed by PPL Electric with those filed by Mr. Galligan and Mr.  
3 Yarolin.

4  
5 Q. Did you make any adjustments to the rate design suggested by Mr. Galligan for  
6 purpose of this comparison?

7 A. No. Mr. Galligan used the same revenue requirement for design of Rate Schedule  
8 RS that was filed by PPL Electric. This allowed for a direct comparison between  
9 the proposed designs of OCA and PPL Electric.

10  
11 Q. Did you make any adjustments to the rate design suggested by Mr. Yarolin for  
12 comparison purposes?

13 A. Yes. Mr. Yarolin prepared his rate design based on the OTS recommendation that  
14 the proposed increase of \$164,436,766 be reduced to \$73,000,000. In accordance  
15 with this recommendation, Mr. Yarolin reduced the residential rate revenue by  
16 about \$30.2 million. His rate design includes a customer charge and two kWh rate  
17 steps. The rate structure is shown below along with the revenues for each rate  
18 component as calculated by Mr. Yarolin.

	<u>Rate</u>	<u>Revenue</u>	<u>Percent of Revenue</u>
Customer Charge	\$8.25/month	\$114,011,964	32.80%
First 800 kWh	\$0.01892/kWh	\$150,771,766	43.38%
All kWh over 800	\$0.01680/kWh	\$82,766,088	23.81%
Totals		<u>\$347,549,818</u>	<u>100.00%</u>

1  
2  
3  
4  
5  
6

Q. What adjustments did you make to Mr. Yarolin's rate structure?

A. I adjusted Mr. Yarolin's rate components to reflect PPL Electric's requested revenue requirement of \$377,750,000 by maintaining the same percent of revenue for each rate component as suggested by Mr. Yarolin. The results are as follows:

	<u>Rate</u>	<u>Revenue</u>	<u>Percent of Revenue</u>
Customer Charge	\$9.07/month	\$123,890,466	32.80%
First 200 kWh	\$0.02056/kWh	\$53,108,038	14.06%
Next 600 kWh	\$0.02056/kWh	\$110,762,789	29.32%
All other kWh	\$0.01824/kWh	\$89,979,356	23.82%
Totals		<u>\$377,740,649</u>	<u>100.00%</u>

7

Q. Were any other adjustments made?

A. Yes. The revenue total of \$377,740,649 for Mr. Yarolin's rate design was calculated based on the number of bills and kWh in each rate step as shown in Exhibit Regs. § 53.53 Filing Requirement IV-C Attachment 1 page 1. The bill determinants used by Mr. Yarolin were somewhat different from those shown in the referenced document.

14

Q. Why were these adjustments made to the OTS rate design?

A. These adjustments were required to allow the rate structures to be compared directly with PPL Electric and the OCA rate structures. The following table summarizes the three proposed rate designs stated on a comparable basis:

18

1

	<u>PPL</u>	<u>OCA</u>	<u>OTS</u>
Customer Charge	\$12.20/month	\$8.00/month	\$9.07/month
First 200 kWh	\$0.0000/kWh	\$0.02292/kWh	\$0.02056/kWh
Next 600 kWh	\$0.02198/kWh	\$0.02087/kWh	\$0.02056/kWh
All other kWh	\$0.01879/kWh	\$0.01964/kWh	\$0.01824/kWh

2

3 Q. What are the primary objectives of PPL Electric's proposed rate design?

4 A. The rate design proposed by the Company achieved the following objectives:

5

- 6 • To keep the rate increase to most customers in the residential class at 10%
- 7 or less on a total bill basis,
- 8 • To have zero to 200 kWh usage bills make a larger contribution to recovering
- 9 fixed costs and
- 10 • To begin the process of moving toward a larger fixed charge and a smaller
- 11 tail block energy rate.

12

13 Q. Why were these objectives chosen?

14 A. As described in Mr. Krall's Testimony (Statement No. 4), more than 90% of the  
15 distribution revenue requirement falls to the residential and commercial customers.  
16 However, the Company recognized that it could not simply apply the results of its  
17 traditional cost allocation study without a very significant increase to the residential  
18 customer classes. Further, PPL Electric wanted to begin taking steps to reduce  
19 existing cross-subsidies among customer classes. Through the process of

1 allocating the requested increase as described in Mr. Krall's testimony and  
2 applying the rate design described in my testimony, PPL Electric was able to limit  
3 the impact of the increase to less than 10% for about 90% of its residential  
4 customers.

5  
6 Q. *Please explain the second rate design objective.*

7 A. There are about 180,000 residential bills issued each year by PPL Electric that  
8 have zero kWh usage (See Attachment 1). There are another 1.2 million  
9 residential bills issued for less than 200 kWh each year. As shown on Attachment  
10 2, there is a definite increase in the number of zero usage bills during the winter  
11 months, when vacation homes and cabins in the Company's service territory are  
12 winterized and closed for 3 to 6 months. In addition, a higher than average  
13 percentage of bills with less than 200 kWh usage have service addresses that are  
14 different from the billing addresses. Attachment 3 shows the results of a study  
15 based on 2002 billing data that compares service and billing addresses by zip  
16 code. This study indicates that about 37% of bills for usage of 200 kWh or less per  
17 month have a billing address that is different from the service address whereas  
18 only about 11% of bills for usage greater than 200 kWh per month have a billing  
19 address that is different from the service address. The seasonal pattern of zero  
20 kWh usage bills along with the high incidence of these bills with different service  
21 and billing addresses indicates that a high percentage of these zero and low-use  
22 accounts are vacation homes or cabins.

23

1 Q. What is the concern with zero usage and low monthly kWh bills?

2 A. The problem is that these low usage customers are not paying their proportionate  
3 share of the fixed costs required to serve a typical residential customer. Zero kWh  
4 usage bills are billed only the Customer Charge of \$6.47 per month and 200 kWh  
5 bills are billed only \$10.06 per month under PPL Electric's current rates. These  
6 amounts are not sufficient to recover the basic customer cost component as  
7 calculated in the company's cost allocation study for the test year ended  
8 December 31, 2004, which is \$21.69/customer per month.

9

10 Q. Does PPL Electric's proposal address this third rate design objective?

11 A. Yes it does. PPL's cost allocation study indicates that for Rate Schedule RS, about  
12 80% of the revenue requirement is part of the customer component and the  
13 remaining 20% is the demand component. Since most costs are fixed and very  
14 little of the revenue requirement is due to demands placed on the distribution  
15 system by residential customers, a larger fixed charge is justified.

16

17 Q. Do the residential rate designs offered by Mr. Galligan and Mr. Yarolin achieve all  
18 three objectives identified above?

19 A. No, they do not.

20

21 Q. How does the PPL Electric proposal compare with the modified OTS and OCA  
22 proposals with regard to keeping the majority of the residential bills below a 10%  
23 increase?

1 A. Nearly 90% of the residential bills would receive an increase of less than 10%  
 2 under rates proposed by the Company. Under the OCA's proposal, about 65% of  
 3 the bills would get an increase of less than 10%. The modified OTS's proposal  
 4 would result in an increase of less than 10% for only 40% of the bills.

	<u>Bills above a 10% Increase</u>	<u>Bills below a 10% Increase</u>	<u>Percent of Bills Below a 10% Increase</u>
PPL Proposal	1,440,000	12,220,000	90%
OCA Proposal	4,745,000	8,915,000	65%
OTS Proposal	8,165,000	5,495,000	40%

6  
 7 Q. Do either of the rate designs suggested by OCA or modified OTS address the  
 8 subsidy between the large usage bills and small or zero kWh usage bills within the  
 9 residential class?

10 A. No. By keeping the customer charge low and not significantly increasing the  
 11 amount paid by very low usage customers, both of these rate designs support the  
 12 low and zero usage customers by increasing the cost to higher kWh usage  
 13 customers.

14  
 15 **Residential Thermal Storage (RTS)**

16  
 17 Q. Do you agree with Mr. Galligan that the Customer Charge for Rate Schedule RTS  
 18 should be increased by only \$1.45/month, the same as his recommendation for  
 19 Rate Schedule RS (Residential Service)?

1 A. No I do not. The fixed costs to serve residential and small commercial customers  
2 (Rate Schedule GS1) are similar. As stated above, the current Customer Charge  
3 *does not recover all fixed costs associated with serving a residential customer and*  
4 *therefore a significant increase in the Customer Charge is justified.* In addition, the  
5 Company tried to maintain the existing relationships between rate options. For  
6 example, the current off peak water heating - single meter (rate provision RW1)  
7 Customer Charge of \$12.61 is a combination of the Rate Schedule RS Customer  
8 Charge of \$6.55 and the off peak water heating – separate meter (rate provision  
9 RWO) Customer Charge of \$6.07. (The one-cent difference is due to rounding  
10 *when STAS is applied*). The Company proposed customer charges of \$20.20 for  
11 rate provision RW1 which is the sum of the proposed \$12.20 customer charge for  
12 Rate Schedule RS, and the proposed \$8.00 customer charge for rate provision  
13 RWO. The Company recommends maintaining the existing rate relationships and  
14 employing gradualism to reduce cross subsidies over time.

15  
16 Q. Do you agree with Mr. Yarolin that the rate of return for Rate Schedule RTS should  
17 *be increased from -3.95% as filed to 0%?*

18 A. No, I do not. The increase needed to make this happen is simply too large (18% in  
19 total) and would compromise the Company's objective of keeping the increase for  
20 the majority of customers at less than 10% in this rate case. The Company agrees  
21 that this rate schedule is producing insufficient revenues and will seek to rectify this  
22 disparity over time.

23

1 Rate Schedules GS1 and GS3

2

3 Q. What comments do you have regarding rates charged to non-profit organizations  
4 under Rate Schedules GS1 and GS3.

5 A. Rates for non-profit organizations that are served under Rate Schedules GS1 and  
6 GS3 will have distribution rates that are identical to the rates established for Rate  
7 Schedule RS.

8

9

Street Lighting

10

11 Q In his testimony PLUG Witness Bradley makes several comments on what he  
12 *perceives as problems with PPL Electric's maintenance of the street lights in*  
13 *Hampden Township. Do you have any response to his comments?*

14 A. Yes. For all types of street lighting, PPL Electric relies upon local police and the  
15 *public to report service interruptions. With 170,000 outdoor lights to operate and*  
16 *maintain, maintaining a staff to continually patrol outdoor lights is cost prohibitive.*  
17 *A call from the local police or the public is much more effective.*

18

19 *Once a malfunctioning light is reported, the Company has a program under which it*  
20 *endeavors to repair 90% of the reported lights within 3 workdays. Of course, there*  
21 *will be a small number of lights that go un-repaired for longer than 3 workdays.*

22 *The reasons for the delay can include availability of crews, material shortages,*  
23 *need to order replacement parts, weather-related work, etc.*

1

2

PPL Electric has reviewed its street lighting maintenance program. We reaffirm our commitment to repair 90% of the reported malfunctioning lights within 3 workdays of the report. The Company's customer support personnel have a heightened awareness of the need to respond to reports of malfunctioning streetlights.

6

7 Q. How has PPL Electric changed its streetlighting maintenance program?

8 Q. In the past, PPL Electric had a group relamping program (up until December 2000).

9 At that time, PPL Electric changed to a program of spot replacements as failures

10 occurred to take advantage of the lamp's full service life. When PPL Electric would

11 receive a notice of a streetlight out of service, the Company would assign the repair

12 to a line crew that was scheduled to be in the area of the reported outage. If a

13 crew was not scheduled in the area, the lamp may have remained out of service for

14 longer than 3 days.

15

16 The Company received a number of complaints about streetlights that were out for

17 extended periods of time (longer than 3 days) with this work process. In 2002, the

18 Company reviewed the existing process of spot replacements and decided to

19 restart the group relamping program.

20

21 Q. What is group relamping?

22 A. Group relamping is a process by which all street light lamp bulbs in a defined

23 geographic area are replaced on a regularly scheduled basis. Under this process,

1 the majority of bulbs in a group are replaced before they burn out instead of being  
2 replaced individually as they fail. The program design is based upon the rated life  
3 of the lamps. At PPL Electric, the group relamping program involves changing  
4 mercury vapor and high-pressure sodium lamps on a 6-year cycle.

5  
6 Q. When did PPL institute the program?

7 A. PPL Electric restarted the program in December 2002. Along with this program,  
8 PPL set a goal of replacing 90% of reported spot outages in 3 days.

9  
10 Q. Are there additional costs with a group relamping program?

11 A. In the short term, yes, because lamps that haven't failed are being replaced in  
12 addition to replacements of all lamps that fail. In the long term, with an economic  
13 replacement cycle, travel, search and diagnostic time savings exceed the loss of  
14 remaining service life.

15  
16 Q. Do you believe that providing feed back to customers on individual lamp outages is  
17 reasonable?

18 A. With regard to his comment on the need for feedback from PPL on reported  
19 outages, it is not practical to provide feedback to each and every outage report with  
20 170,000 outdoor lights to monitor.

21  
22 Q. Mr. Bradley suggests that outage credits be given for street lights that are out for a  
23 period of time longer than the 3 days. What is your opinion on outage credits?

1  
2 A. PPL Electric's maintenance program includes group re-lamping for all those street  
3 lights that PPL Electric is responsible to maintain, which reduces the occurrence of  
4 spot failures. The program also includes a goal to restore service to those street  
5 lights for which PPL Electric provides maintenance within 3 workdays, after they  
6 are reported out of service by customers. With this program in place, the value of  
7 outage credits is outweighed by the cost to administer them. In my opinion, global  
8 outage credits are not an efficient way of dealing with those relatively few situations  
9 in which a light is out for an extended period.  
10

11 **Tariff Correction for**  
12 **Economic and Industrial Development Initiatives Rider**

13  
14 Q. What are the corrections that are being submitted with your rebuttal testimony with  
15 regard to the Proposed Economic Development Initiatives (EDI)/Industrial  
16 Development Initiatives (IDI) Rider?  
17 A. As noted in the Proposed Changes Requested in Supplement No. 38 to Tariff Pa.  
18 P.U.C. #201, and as described in my direct testimony, the Company has proposed  
19 to eliminate the EDI and IDI Rider credits for Distribution Service. Credits for Basic  
20 Utility Supply Service (energy and capacity) will continue until the generation rate  
21 caps expire at the end of 2009. Under this proposal, the total EDI/IDI credits for an  
22 existing customer purchasing Basic Utility Supply Service from PPL Electric will be  
23 as follows:  
24

Rate Schedule	GS-3	LP-4	LP-5
Demand	\$1.73/kW	\$1.86/kW	\$1.98/kW
Energy	\$0.0086/kWh	\$0.0093/kWh	\$0.0099/kWh

1

2

The total EDI/IDI credits for a new customer purchasing Basic Utility Supply

3

Service from PPL Electric will be as follows:

4

Rate Schedule	GS-3	LP-4	LP-5
Energy	\$0.0086/kWh	\$0.0093/kWh	\$0.0099/kWh

5

6

These changes will be reflected in the compliance filing.

7

8

Q. Does that conclude your testimony?

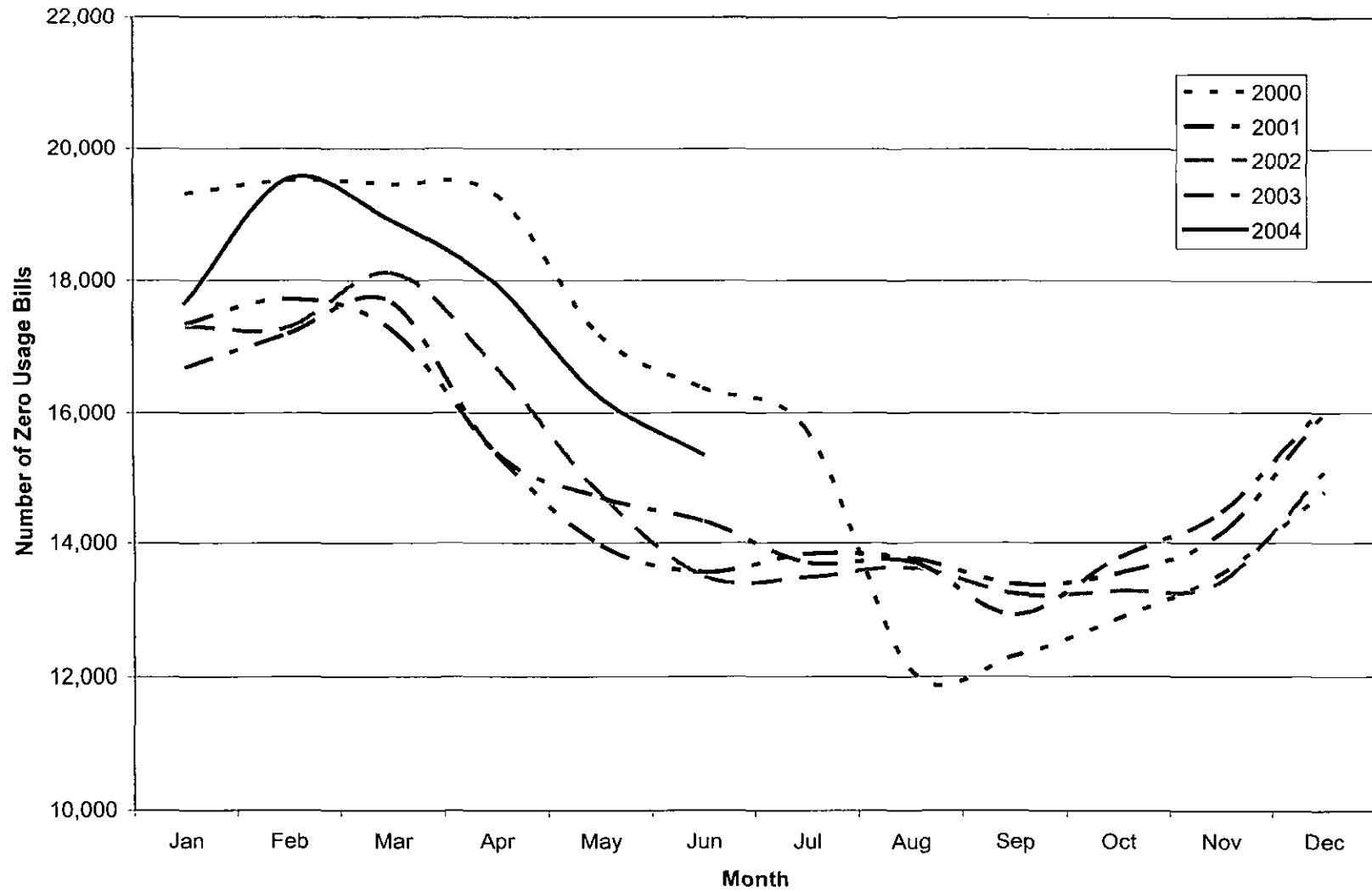
9

A. Yes, it does.

10

KWh step	Number of Bills		Bills Share	
	Total Residential		Total Residential	
			% of Total Residential	Cumulative Percent
0	176,959		1.31%	1.31%
25	159,195		1.18%	2.48%
50	105,467		0.78%	3.26%
75	112,672		0.83%	4.10%
100	126,928		0.94%	5.03%
150	324,190		2.40%	7.43%
200	413,991		3.06%	10.49%
250	476,115		3.52%	14.01%
300	525,707		3.88%	17.89%
350	555,634		4.11%	22.00%
400	574,575		4.25%	26.24%
450	581,321		4.30%	30.54%
500	573,524		4.24%	34.78%
550	561,654		4.15%	38.93%
600	542,766		4.01%	42.94%
650	517,234		3.82%	46.76%
700	493,480		3.65%	50.41%
750	465,081		3.44%	53.84%
800	436,841		3.23%	57.07%
850	406,932		3.01%	60.08%
900	380,723		2.81%	62.89%
950	352,921		2.61%	65.50%
1,000	328,186		2.43%	67.92%
1,050	303,798		2.24%	70.17%
1,100	281,839		2.08%	72.25%
1,150	260,460		1.92%	74.18%
Over 1,150	3,494,743		25.82%	100.00%
TOTAL	13,532,936		100.00%	

# Zero Usage Bills



KWH Step	ALL Residential Bills			Percent of Two Zip Code Bills
	Total	One Zip Code	Two Zip Code	
0	176,959	76,485	100,474	
25	159,195	83,772	75,423	
50	105,467	56,280	49,187	
75	112,672	63,633	49,039	
100	126,928	78,109	48,819	
150	324,190	225,199	98,991	
200	413,991	315,563	98,428	
<b>Totals</b>	<b>1,419,402</b>	<b>899,041</b>	<b>520,361</b>	<b>0.3666</b>
250	476,115	382,895	93,220	
300	525,707	437,795	87,912	
350	555,634	473,559	82,075	
400	574,575	497,318	77,257	
450	581,321	508,453	72,868	
500	573,524	506,208	67,316	
550	561,654	498,100	63,554	
600	542,766	483,236	59,530	
650	517,234	462,234	55,000	
700	493,480	442,349	51,131	
750	465,081	417,542	47,539	
800	436,841	392,890	43,951	
850	406,932	365,943	40,989	
900	380,723	342,439	38,284	
950	352,921	317,665	35,256	
1,000	328,186	295,895	32,291	
1,050	303,798	274,125	29,673	
1,100	281,839	253,985	27,854	
1,150	260,460	234,837	25,623	

**DOCUMENT**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-00049255**

**PPL Electric Utilities Corporation**

**DOCKETED**

**JUL 28 2004**

**Statement No. 7-R**

**Rebuttal Testimony of Timothy R. Dahl**

1 **Rebuttal Testimony of Timothy R. Dahl**

2 Q. Please state your full name and business address.

3 A. My name is Timothy R. Dahl and my business address is PPL Electric Utilities,  
4 827 Hausman Road, Allentown, PA 18104.

5

6 Q. What is your position at PPL Electric Utilities ("PPL Electric" or "Company")?

7 A. I am the Manager – Regulatory Programs & Business Services in PPL Electric's  
8 Customer Services Department. I report directly to the Vice President –  
9 Customer Services.

10

11 Q. What are your major responsibilities?

12 A. My responsibilities include oversight of the Company's universal service  
13 programs, quality assurance and compliance with PUC Chapter 56 regulations  
14 and the Customer Choice program. I serve as PPL Electric's liaison with various  
15 state agencies (e.g., Commission's Bureau of Consumer Services) regarding  
16 these three areas of responsibility.

17

18 Q. What is the purpose of your rebuttal testimony regarding PPL Electric's request  
19 for increased rates?

20 A. My purpose is to respond to various witnesses' proposals and concerns  
21 regarding the Company's universal service programs, Sustainable Energy Fund  
22 ("SEF") and the Community Betterment Initiative ("CBI").

23

1 Q. In general terms, could you please summarize the key recommendations  
2 identified by the various witnesses?

3 A. Yes, I will. Several witnesses offered suggestions and comments regarding  
4 PPL's major universal service programs, which include the Company's OnTrack  
5 payment program (known generically as a Customer Assistance Program or  
6 "CAP"), the free weatherization program (Winter Relief Assistance Program or  
7 "WRAP") and the Operation HELP hardship fund.

8

9

I. Summary of Recommendations

10 Q. In summary, what are the key recommendations offered by witnesses regarding  
11 PPL Electric's universal service programs?

12 A. **OnTrack:** Witnesses Eugene Brady and John Howat (Commission on Economic  
13 Opportunity or "CEO") and Roger Colton (Office of Consumer Advocate or  
14 "OCA") all contend that the program is not appropriately funded. Although  
15 neither witnesses Brady nor Howat provides a recommended level of funding for  
16 OnTrack, they suggest participation levels of 50 percent and 35 percent,  
17 respectively, for low-income customers. Similarly, Mr. Colton does not offer a  
18 specific level of annual funding for OnTrack; instead, he recommends that PPL  
19 Electric unilaterally impose a payment plan for all confirmed low-income  
20 customers who are in arrears and not on payment plans. Witness Colton  
21 suggests that the Company conduct a pilot program to help low-income  
22 customers in arrears to file for and receive the federal Earned Income Tax Credit.  
23 In theory, customers would use these additional dollars to pay their overdue  
24 balances for electric service. Both witnesses Howat and Colton contend that

1 PPL Electric must conduct more outreach for the OnTrack payment program.

2 Witnesses Brady, Howat and Colton recommend that the Company eliminate the  
3 payment-trouble requirement of OnTrack and open the program to a much larger  
4 population of low-income customers.

5 **WRAP:** Mr. Howat recommends increasing the funding level to \$7 million  
6 annually for this program, beginning in 2005 and continuing through 2011.

7 Witness Howat suggests that PPL Electric devote \$1 million annually to solar  
8 water heating installation for low-income customers during this period of time.

9 PPL Electric has proposed to ramp up expenditures for OnTrack and  
10 WRAP over a period three years and to "normalize" costs over a period of six  
11 years. Witness Colton recommends that the Company "normalize" these  
12 additional costs over a period of two years. Mr. Colton suggests that all  
13 customers – not just residential – should pay for PPL Electric's universal service  
14 programs. Witness Eric Epstein suggests that PPL Corporation use shareholder  
15 funding to match the annual funding levels for both OnTrack and WRAP.

16 **Operation HELP:** Witness Colton recommends that PPL Electric file a  
17 plan with the Commission's Bureau of Consumer Services to increase donations  
18 to Operation HELP by 20 percent. Under Mr. Colton's proposal, the Company  
19 would submit this plan within 90 days of the disposition of the rate case. Witness  
20 Colton also suggests that PPL Corporation increase its annual shareholder  
21 contributions to Operation HELP. Witness Epstein recommends that the  
22 Company should use shareholders' funds to match ratepayers' contributions to  
23 Operation HELP.

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23

Q. What were the major recommendations offered by the various witnesses regarding the Sustainable Energy Fund ("SEF" or "Fund")?

A. The recommendations regarding the SEF vary widely from eliminating all funding entirely to doubling the amount of annual funding to allocating 36 percent of all funding to residential customers to turning over the administration of the Fund to the Pennsylvania Energy Development Authority ("PEDA"). Witnesses Thomas Prisco (Department of the Army), Stephen Baron (PPL Industrial Customer Alliance) and Michael Gruber (PUC's Office of Trial Staff) recommend the elimination of all ratepayer funding for the SEF. Witnesses Brady and Howat suggest allocating the 36 percent of SEF funding collected from the residential class to a grant program to install photovoltaic units for residential customers, including low-income households. Witness John Hanger (PennFuture) recommends increasing the funding level for SEF from .01 cents per kWh to .02 cents per kWh. Mr. Hanger further states that neither the Company's 1998 Settlement Agreement or any Commission Order requires the expiration of funding from PPL Electric's customers for the SEF. Witness Andrew Schwarz (Office of Small Business Advocate) recommends that PPL Electric turn over the management of the SEF to PEDA to ensure better coordination of funding and more effective accountability. Witnesses Joseph Link, Michael Musser and John Bradley (Public Lighting User Group or "PLUG") note that PLUG plans to explore the availability of grants from the SEF. Mr. Link recommends that the Commission set standards for the implementation of the Fund and, in particular,

1 compensation for the SEF's Board of Directors.

2

3 Q. What were the primary recommendations regarding PPL Electric's proposal to  
4 implement the Community Betterment Initiative ("CBI")?

5 A. Witnesses Colton and Howat both indicated their support for the CBI, but Mr.  
6 Howat recommended the implementation of a formal review process for grants  
7 that includes the involvement of community-based organizations. Although not  
8 opposed to the objectives of the program, Witnesses Prisco and Weakley  
9 recommend no funding from ratepayers for the CBI. Witness Epstein suggested  
10 that PPL Electric match ratepayer funding for the CBI with funding from  
11 shareholders.

12

13

## 13 II. Summary of PPL Electric's Concerns

14 Q. Would you summarize, in general terms, PPL Electric's major concerns with the  
15 recommendations and issues identified by the various witnesses regarding the  
16 universal service programs, the Sustainable Energy Fund and the Community  
17 Betterment Initiative?

18 A. **Universal Service Programs:** With respect to the recommendations offered by  
19 the witnesses, the Company takes exception to the following:

20 1. **OnTrack not adequately funded and available** -- PPL Electric disagrees  
21 with this conclusion. The Company's Settlement Agreement clearly  
22 delineated the annual funding level for OnTrack, and PPL Electric has  
23 managed the program to meet those expenditure requirements. The  
24 opposing parties fail to address the fundamental purpose of OnTrack, which

1 is to assist low-income, payment-troubled customers (i.e., overdue balances  
2 and poor payment histories). A dramatic increase in funding would increase  
3 rates for all residential customers, including low-income households. PPL  
4 Electric has proposed a balanced approach that increases OnTrack funding  
5 and also tempers the rate impact on residential customers.

6 2. **More outreach for OnTrack** -- The Company disagrees with this suggestion  
7 because ten years of experience with OnTrack shows that there are sufficient  
8 referrals to meet the program's expenditure requirements. If needed, PPL  
9 Electric has a variety of resources in place to increase referrals to OnTrack.

10 3. **Elimination of overdue balance for OnTrack** -- The Commission's Policy  
11 Statement on Customer Assistance Programs clearly indicates that programs  
12 like OnTrack should target payment-troubled customers (e.g., overdue  
13 balances and poor payment histories). Expanding OnTrack to a much  
14 broader low-income audience would increase costs significantly. Even  
15 overlooking the implementation logistics and difficulties, it would cost  
16 ratepayers approximately \$40 million annually to support an enrollment of  
17 40,000 customers in OnTrack as suggested by Witness Howat.

18 4. **Unilateral payment plans** -- PPL Electric believes this "negative" check-off  
19 approach would anger customers, result in numerous PUC complaints, affect  
20 the level of customer satisfaction and increase costs.

21 5. **Earned Income Tax Credit Pilot** -- The Company believes this proposal is  
22 impractical and would be difficult to implement and manage. It would also be  
23 duplicative of programs already run by community action agencies. In the

1 end, customers would be free to spend their tax return as they see fit.

2 Nevertheless, PPL Electric would consider conducting a limited pilot.

3 6. **\$1 million for low-income solar water heating** -- The Company disagrees  
4 with this suggestion. PPL Electric's experience with its renewable energy  
5 pilot revealed the challenges and difficulties of finding suitable locations to  
6 install solar water heating units. The Company's recommendation to expend  
7 approximately \$600,000 yearly on solar water heating is a more balanced,  
8 practical and achievable approach.

9 7. **Outreach plan for Operation HELP** -- PPL Electric believes this  
10 recommendation to increase customer funding by 20 percent is impractical for  
11 a mature program (started in 1983) like Operation HELP. The Company  
12 believes that implementing an aggressive fund-raising campaign may have a  
13 negative effect on contributions. Moreover, this is a voluntary program not  
14 reflected in customers' rates. The scope and size of Operation HELP are  
15 matters for PPL Electric to determine.

16 8. **Low-income programs funding from all customers** -- PPL Electric does  
17 not support this proposal. As designed and implemented, the Company  
18 believes that the greatest benefits associated with the low-income programs  
19 ultimately accrue to residential customers.

20 9. **Revenue adjustments for OnTrack and WRAP** -- The Company disagrees  
21 that it has double counted the OnTrack arrearage forgiveness provision. The  
22 Company also has concerns about reducing funding for OnTrack and WRAP  
23 because there is no guarantee that PPL Electric will file for another base rate

1 increase in two years.

2 **Sustainable Energy Fund (“SEF”):** Regarding the various recommendations  
3 directed toward the SEF, PPL Electric had the following concerns:

- 4 1. **No funding for SEF** -- The Company does not support this position because  
5 continuation of the SEF supports public policy objectives regarding the  
6 environment, establishes partnerships with government to address  
7 environmental needs and promotes the development of renewable energy  
8 technologies. All of which the Company believes would be to the overall  
9 benefit of all ratepayers.
- 10 2. **Double SEF funding** – PPL Electric disagrees with this proposal to double  
11 the annual funding level. The Company believes that funding the SEF at its  
12 current level (.01 cents per kWh) is the appropriate amount of support. What  
13 happens in other states may not be germane to or appropriate for  
14 Pennsylvania. The Company suggests a balanced approach that continues  
15 support for the SEF while, at the same time, is cognizant of the cost impact  
16 on customers.
- 17 3. **SEF funding for a photovoltaic (“PV”) grant program** -- PPL Electric  
18 disagrees with the recommendation to allocate 36 percent of SEF funding for  
19 a PV grant program. First, nothing in the 1998 Settlement Agreement  
20 earmarks funding for specific classes of customers or for specific activities.  
21 Second, the cost effectiveness of PV systems (30-year payback period) is not  
22 favorable when compared with solar water heating (7-10 year payback  
23 period). Finally, the SEF staff and Board of Directors need the flexibility and

1 the responsibility to invest customer-provided funds in ways that provide the  
2 greatest payback and meet the overall mission of the Fund.

3 4. **Source of SEF funding** -- PPL Electric disagrees with the conclusion that  
4 shareholders rather than customers are actually funding the SEF. As a result  
5 of its 1998 Settlement Agreement, PPL Electric established a tariff that  
6 funded the SEF from the distribution charges in each rate schedule at .01  
7 cents per kWh (less applicable Gross Receipts Tax) on all kWh delivered to  
8 all customers.

9 5. **Administration of the SEF by PEDA** -- The Company disagrees with the  
10 recommendation to have the management of the SEF's funds turned over to  
11 PEDA. From PPL Electric's perspective, the Commission has sufficient  
12 oversight capabilities to ensure the proper expenditure of funds, to avoid  
13 conflict of interests and to encourage coordination of efforts among the  
14 various Sustainable Energy Funds. In addition, the Commission's  
15 Pennsylvania Sustainable Energy Board has oversight and coordination  
16 responsibilities for the SEFs.

17 **Community Betterment Initiative ("CBI"):** PPL Electric has several concerns  
18 with recommendations regarding the proposed implementation of the CBI.

19 1. **No funding for CBI** -- The Company disagrees with this recommendation  
20 because a modest investment in the CBI should return solid benefits in terms  
21 of leveraging state funds and maximizing the impact of local community and  
22 economic development efforts in a variety of areas. Job creation and tax  
23 base enhancement meet the needs of many Pennsylvania communities, and

1 survey research of customers and community leaders has consistently shown  
2 that economic development is near or at the top of their key priorities.

3 2. **CBI formal review process** -- PPL Electric believes that establishing a  
4 formal review process with all relevant stakeholders to oversee the allocation  
5 of CBI funds would be cumbersome and could result in delays or conflicts of  
6 interest since many of the stakeholders are also likely to be applicants. The  
7 Company would develop an internal process to evaluate, select and award  
8 CBI grants to community organizations. Through the implementation of its  
9 successful Community Partnership Program (1995 - 1997), PPL Electric  
10 demonstrated its ability to successfully implement a similar grant program.  
11 The Company also has years of experience in evaluating proposals and  
12 awarding funding for a variety of community and economic development  
13 initiatives. A key funding criterion will be compliance with formal community  
14 and economic development strategies of municipalities and other local  
15 stakeholders such as non-profit development groups, assuring that their  
16 thinking is factored into the decision-making process.

17  
18 III. PPL Electric's Responses to Recommendations  
19 Re: Universal Service Programs

20 Q. Do you have other concerns and issues about the recommendations offered by  
21 the various witnesses regarding the universal service programs, the SEF and the  
22 CBI?

23 A. Yes, I do. In addition to presenting more detail of PPL Electric's concerns  
24 regarding the above recommendations, I will address other subordinate, yet

1 important recommendations presented in the witnesses' testimony.

2

3 Q. Does PPL Electric have specific concerns and comments regarding the  
4 recommendations presented by the various witnesses for the universal service  
5 programs?

6 A. Yes, I have identified and responded below to those specific concerns regarding  
7 OnTrack, WRAP and Operation HELP.

8

9 Q. What are PPL Electric's major issues and concerns regarding the OnTrack  
10 payment program?

11 A. Witnesses Brady, Howat and Colton all note a PUC Order dated June 12, 2003,  
12 at Docket No. M-00031698, indicating that OnTrack was neither appropriately  
13 funded nor available in the Company's service area. This Order approved the  
14 Company's three-year (2004 - 2006) Universal Service & Energy Conservation  
15 Plan. PPL Electric disagrees with this conclusion. Under the terms of its 1998  
16 Settlement Agreement, all parties agreed to an annual funding level of \$11.7  
17 million for OnTrack. The parties also agreed that PPL Electric would ramp up  
18 expenditures over a four-year period. The maximum funding amount of \$11.7  
19 million for OnTrack would remain in effect until the Company requested  
20 permission from the Commission to change the annual level of funding. From  
21 1999 through 2003, the Settlement Agreement required PPL Electric to expend a  
22 total of \$47.3 million for OnTrack. Over this period of five years, the Company  
23 expended approximately \$47.6 million, or 101 percent of the required funding.

1 Given the mandatory cap on electric rates, PPL Electric managed OnTrack to  
2 stay within the budget approved by all parties to the 1998 Settlement Agreement.  
3 PPL Electric recognizes that there is an opportunity to expand OnTrack  
4 enrollment and has proposed to increase annual funding for the program by 25.6  
5 percent.

6 Witness Howat indicates that one of the reasons for the inappropriate  
7 funding of OnTrack is attributable to excessive administrative costs. PPL Electric  
8 disputes this conclusion. The following table shows the average administrative  
9 cost for OnTrack over the past three years.

10

<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Average</b>
18.7%	20.8%	14.2%	17.6%

11

12 The Company's overall administrative costs for OnTrack are, according to the  
13 Commission's latest *Report on 2002 Universal Service Programs & Collections*  
14 *Performance*, significantly below the electric industry average of 38 percent.  
15 Through June 2004, PPL Electric has continued to keep the administrative costs  
16 for OnTrack below 15 percent.

17 Witnesses Brady and Howat recommend that PPL Electric expand the  
18 percentage of low-income customers served by OnTrack to 50 percent and 35  
19 percent, respectively. The Company disagrees with this recommendation for two  
20 reasons: 1) these penetration percentages would be excessively expensive and  
21 2) these penetration percentages are impractical. Mr. Brady identifies from his  
22 perspective an eligible population (i.e., at or below 150 percent of the federal  
23 poverty level) of 200,250 low-income customers. PPL Electric's average annual

1 cost for an OnTrack customer is \$998 and includes all program costs (e.g.,  
2 revenue shortfall, arrearage forgiveness and administration). Under Witness  
3 Brady's scenario, the Company would need an annual OnTrack budget of nearly  
4 \$100 million (200,250 x 50 percent = 100,125 x \$998). Similarly, Witness Howat  
5 identifies an eligible audience of nearly 114,000 low-income customers.  
6 Assuming a penetration rate of 35 percent, PPL Electric would need an annual  
7 budget of nearly \$40 million for OnTrack (114,000 x 35 percent = 39,900 x \$998).

8 Using broad indicators (e.g., Witness Brady's use of 2000 U.S.  
9 Census data) of eligibility for OnTrack are inappropriate. The following factors  
10 act as "filters" to reduce customers' participation in the program.

- 11 • Not payment-troubled.
- 12 • Live in master-metered apartments.
- 13 • Referred by PPL Electric to OnTrack but do not participate.
- 14 • Apply and are ineligible for the program.
- 15 • Know about the program but do not apply.

16 Most of PPL Electric's low-income customers (approximately 80 percent) are not  
17 payment troubled (i.e., overdue balances and history of missed payments).

18 Commission regulations at 52 Pa. Code § 69.265 (10)(ii)(B) require utilities to  
19 evaluate the impacts of low-income programs at no more than six-year intervals.

20 PPL Electric, through a competitive bidding process, selected The RETEC  
21 Group, Inc. ("RETEC") from New Haven, CT to conduct the evaluation. RETEC  
22 estimated the market of likely OnTrack participants to be approximately 30,000.

23 PPL Electric generally concurs with RETEC's finding.

1           However, as noted above, being eligible for OnTrack does not  
2 automatically translate into participation in the program. PPL Electric's records  
3 from 2001 through 2003 show a ratio of 1:2 regarding referrals and enrollments  
4 in OnTrack. In other words, for every ten customers referred, five customers will  
5 eventually enroll in the program. RETEC concluded in its study that slightly more  
6 than one in four customers referred to OnTrack fail to respond to contact  
7 attempts or are ineligible. Approximately 95 percent of all OnTrack referrals  
8 come from the Company's telephone agents who negotiate payment plans.  
9 Other referrals come from community-based organizations ("CBOs") that  
10 administer programs like OnTrack, WRAP and Operation HELP. The following  
11 table shows the ratio of referrals to enrollments over the past three years.

<b>Activity</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Total</b>
Referrals	15,830	23,302	35,255	74,387
Enrollments	7,050	13,732	18,471	39,253
<b>Ratio</b>	<b>1:2.2</b>	<b>1:1.7</b>	<b>1:1.9</b>	<b>1:1.9</b>

13  
14           Although the estimated population for active enrollment in OnTrack is  
15 approximately 30,000 customers, it is unlikely that PPL Electric could reasonably  
16 achieve this level of participation. The Company's practical experience with  
17 referrals and enrollments over the past three years appears to confirm this  
18 conclusion. PPL Electric's proposal to increase funding by 25.6 percent (i.e.,  
19 from \$11.7 million to \$14.7 million) would allow the Company to have a range of  
20 15,000 to 17,000 customers enrolled in OnTrack. Not only does this level of  
21 funding appear to match customers' need for the program, it also would have a  
22 manageable impact on the current delivery structure for OnTrack by allowing the

1 CBOs to absorb the additional workload with minimal interruption.

2 In addition to the protections and benefits offered to customers  
3 through programs like OnTrack, PPL Electric's philosophy and approach toward  
4 credit and collection activities helps low-income households as well. Among the  
5 13 jurisdictional electric and gas utilities in Pennsylvania, PPL Electric has the  
6 lowest termination rate. According to the Commission's *Report on 2002*  
7 *Universal Service Programs & Collections Performance*, the Company's  
8 termination rate, as determined by the Bureau of Consumer Services, was 0.68  
9 percent. The average for all electric utilities and gas utilities was 1.75 percent  
10 and 2.78 percent, respectively. In other words, residential customers at other  
11 electric utilities are two and a half times more likely to have their service shut off  
12 for non-payment than a PPL Electric residential customer. Customers at the gas  
13 companies are four times more likely to have their service terminated for non-  
14 payment than a PPL Electric residential customer.

15 Witness Colton recommends that each May PPL Electric should identify  
16 all confirmed low-income customers in arrears and not on payment plans and  
17 unilaterally impose budget billing payment plan. This so-called "opt-out" payment  
18 arrangement would require these customers to contact the Company in order to  
19 negotiate a payment plan consistent with the Commission's guidelines. PPL  
20 Electric does not support this proposal for the following reasons:

- 21 • It would anger many customers.
- 22 • It would increase the Company's call volume and costs.
- 23 • It would increase complaints to the Commission, which would further

1                   increase costs for PPL Electric.

- 2                   • It would adversely affect customer satisfaction.
- 3                   • It would not be necessary for all customers because they may pay their
- 4                   overdue balances (e.g., LIHEAP grant).
- 5                   • It would not necessarily guarantee that customers would make
- 6                   payments.

7                   The Commission's payment arrangement guidelines already encourage utilities  
8                   to establish budget billing payment plans for low-income customers that include a  
9                   portion of the arrearage. The Commission further clarified this guideline in a  
10                  formal complaint case (Mary Frayne v. PECO Energy, at Docket No. C-  
11                  20029005).

12                  Witnesses Howat, Colton and Brady recommend that PPL Electric expand  
13                  its outreach efforts for OnTrack and eliminate the requirement for income-eligible  
14                  customers to have an overdue balance of \$150 to qualify for the program. They  
15                  conclude that the Company is not "proactive" enough in identifying and referring  
16                  low-income customers to the program and that the \$150 requirement  
17                  discriminates against low-income customers who forgo necessities to pay their  
18                  utility bills. PPL Electric disagrees with this characterization of its outreach  
19                  efforts for OnTrack and its focus on low-income, payment-troubled customers.  
20                  The Commission's Policy Statement on Customer Assistance Programs ("CAPs")  
21                  at 52 Pa. Code § 69.261 and § 69.264 clearly states that CAPs should target  
22                  low-income, payment troubled customers. As such, the Company has directed  
23                  its OnTrack enrollment efforts at low-income customers with overdue balances

1 and poor payment histories. PPL Electric's objective has been to match  
2 customer enrollment levels with available funding resources. As indicated  
3 earlier, PPL Electric has been successful in increasing program enrollment while  
4 also expending the level of funds agreed to by all parties in the 1998 Settlement  
5 Agreement.

6 Opening OnTrack to a much broader audience of low-income customers  
7 (e.g., no overdue balance) creates serious concerns regarding the annual  
8 funding level, implementation challenges, increased administrative costs,  
9 additional technology costs, etc. The Company also believes it is important to  
10 keep rates as reasonable as possible for low-income customers. PPL Electric  
11 contends this magnitude of expansion is beyond the scope of what the  
12 Commission intended in its CAP Policy Statement. The equity issue (i.e., low-  
13 income customers not purchasing necessities to pay utility bills) requires a broad-  
14 based approach best addressed by the federal and/or state government. This  
15 type of far-reaching social issue is outside the purview of electric utilities.

16 Through its normal process of negotiating payment plans, the Company  
17 has a sufficient pool of low-income, payment-troubled customers to refer to  
18 OnTrack. The Company's phone reps take an active role in referring customers  
19 to the program. They explain the eligibility requirements, they send an electronic  
20 referral note to the appropriate OnTrack CBO, and they send a letter to the  
21 customer to reinforce the benefits of OnTrack. However, if needed, PPL Electric  
22 can conduct additional outreach efforts to identify eligible customers. For  
23 example, the Company has utilized bill inserts and radio and TV ads to promote

1 OnTrack. The Company has implemented special outbound calling programs  
2 after normal weekday work hours or on Saturdays to inform customers about the  
3 availability and advantages of OnTrack. PPL Electric's Customer Programs  
4 Directors, who have the day-to-day responsibility for OnTrack, also can work  
5 through their extensive network of CBOs to increase referrals to the program.  
6

7 Q. What other recommendations have the witnesses offered regarding the OnTrack  
8 payment program?

9 A. Witness Colton recommends that PPL Electric implement a pilot outreach  
10 program to assist low-income customers in applying for and receiving the federal  
11 Earned Income Tax Credit ("EITC"). This proposal, although well intended,  
12 presents a variety of concerns and challenges, including the following:

- 13 • Performing considerable administrative work (e.g., identifying  
14 customers, determining eligibility, explaining EITC requirements and  
15 completing EITC forms).
- 16 • Developing and implementing various customer communication efforts  
17 (e.g., fact sheets, Q&A brochure, letters, list of tax preparation offices  
18 and phone scripts).
- 19 • Handling ongoing customer inquiries and concerns regarding the EITC  
20 process.
- 21 • Monitoring, managing and evaluating the pilot.

22 In addition, obtaining an EITC refund is no guarantee that customers would use  
23 the funds to pay their utility bills. They could, for instance, use the refund to

1 purchase other necessities (e.g., prescription medicines). Mr. Colton indicates  
2 that New Jersey's results from 1994, which obviously is dated information, shows  
3 that 25 percent of EITC recipients used part of the refund to pay utility bills. PPL  
4 Electric has had a mixed experience with subsidized housing residents who  
5 receive utility allowances, but use the funds to purchase other goods rather than  
6 pay their electric bills. At the end of the day, customers are free to spend the  
7 EITC refund as they see fit.

8 These concerns and issues notwithstanding, PPL Electric would consider  
9 developing and implementing a limited pilot to determine the efficacy of  
10 promoting the EITC for low-income households. The Company could target  
11 selected areas where local social service agencies that administer programs like  
12 OnTrack and WRAP also have experience in promoting the EITC. For example,  
13 Schuylkill Community Action in Pottsville has effectively administered PPL  
14 Electric's low-income programs for many years and has conducted a program to  
15 encourage clients to apply for the EITC.

16 Witnesses Brady and Howat contend that the characterization of CBO  
17 costs for OnTrack as "administrative" costs is improper. Mr. Brady states that  
18 CBO costs are better described as operational or direct service costs. The  
19 Commission's Bureau of Consumer Services requires all jurisdictional electric  
20 utilities and gas utilities to report CAP costs under three categories: revenue  
21 shortfall, arrearage forgiveness and administration. Revenue shortfall is the  
22 difference between customers' actual bills and their CAP bills. Arrearage  
23 forgiveness is the amount of pre-program arrearage that the utility write-offs

1 when CAP customers meet certain payment criteria. Administration includes all  
2 other costs (e.g., salaries and benefits for utility employees, payments to CBOs,  
3 computer hardware and software, printing and postage).

4           Witness Colton expressed concern about the accuracy of the OnTrack fact  
5 sheet and recommended that the Company revise it to reflect the operation of the  
6 program. The current OnTrack fact sheet indicates that PPL Electric may  
7 remove customers from the program for not having applied to LIHEAP or for  
8 exceeding 110 percent of their historical kWh usage. The Company included this  
9 wording in the fact sheet to encourage customers to apply for LIHEAP and to  
10 control their kWh usage. Both of these efforts help to improve the cost  
11 effectiveness of OnTrack. The Commission's CAP Policy Statement  
12 recommends that utilities encourage customers to apply for LIHEAP benefits.  
13 The CAP Policy Statement does allow companies the option of imposing a  
14 penalty if customers do not apply for LIHEAP and it recommends a kWh limit of  
15 110 percent of historical usage. However, to ensure clarity and consistency, PPL  
16 Electric agrees to revise its OnTrack fact sheet.

17  
18 Q. Do you have any other comments or observations regarding the OnTrack  
19 payment program?

20 A. PPL Electric recognizes the importance of OnTrack and has proposed to  
21 increase funding for the program. The Company has structured and  
22 implemented the program to address the needs of low-income customers while  
23 balancing business, financial, regulatory and public policy interests. PPL Electric

1 will continue to help payment-troubled customers achieve self-sufficiency by  
2 providing affordable payments and by referring them to other assistance  
3 programs. The Company's objectives for OnTrack are clear:

- 4 • Administer a cost-effective program.
- 5 • Provide meaningful services to low-income customers.
- 6 • Expand enrollment in a cost-effective and manageable fashion.
- 7 • Adhere to PUC regulations and reporting requirements.
- 8 • Identify and implement improvements to strengthen the effectiveness  
9 of OnTrack.

10  
11 Q. What have the witnesses recommended for WRAP?

12 A. Witness Howat recommends an increase in the annual funding level for WRAP to  
13 \$7 million with an allocation of \$1 million annually from the total funding for solar  
14 water heating. PPL Electric has proposed to continue solar water heating as a  
15 standard WRAP measure for customers who meet the various eligibility  
16 requirements. However, the Company disagrees with increasing the WRAP  
17 budget to \$7 million and allocating \$1 million annually for solar water heating  
18 installations. PPL Electric recommends a three-year ramp up in the level of  
19 WRAP expenditures and installations for solar water heating. The Company  
20 proposes the following:

21

<b>Year</b>	<b>Est. Funding</b>	<b>Est. Installations</b>
2005	\$325,000	65
2006	\$475,000	95
2007	\$600,000	120

1 Q. Does the Company have any concerns or comments regarding Mr. Howat's  
2 recommendation?

3 A. Yes, PPL Electric believes that Witness Howat's proposed \$1 million annual  
4 budget for solar water heating installations is overly optimistic for the following  
5 reasons. First, finding homes that meet the selection criteria (e.g. proper roof  
6 orientation, no shade trees, adequate kWh usage and structural integrity of the  
7 home) is very challenging. To find the 89 participants for the solar water-heating  
8 and PV pilots, the Company and CBOs had to analyze/evaluate nearly 3,600  
9 customer locations. Based on the experience with the solar water-heating pilot,  
10 the Company believes that approximately two to four percent of WRAP  
11 participants' homes are good candidates for solar water heating. Second, the  
12 selection process is further complicated by the fact that customers must consent  
13 to the installation of the system and must have demonstrated capacities for  
14 managing energy use and understanding the system. Third, installing a solar  
15 water heating ("SWH") system is time consuming. Results from PPL Electric's  
16 pilot show that it takes two qualified workers 2.5 days to complete one  
17 installation. Mass production would not necessarily increase efficiency because  
18 every home is different; in other words, there is no "cookie cutter" approach to  
19 installing SWH units. In addition, training new contractors for SWH is time  
20 consuming and expensive. Finally, installing solar water units affects the  
21 productivity associated with traditional WRAP jobs. The four qualified  
22 community-based organizations ("CBOs") installed most of the SWH and PV  
23 units in 2002. PPL Electric struggled to meet its WRAP expenditure goal in 2002

1 partly because of the greater than anticipated drain that the solar water heating  
2 and PV pilots had on the CBOs' weatherization personnel.

3  
4 Q. Does PPL Electric have any other concerns with Witness Howat's  
5 recommendations regarding WRAP?

6 A. Yes, Mr. Howat suggested that there is a pressing need for WRAP contractors to  
7 increase their decision-making capabilities regarding the design elements of the  
8 program. PPL disagrees with this conclusion for the following reasons. First, the  
9 Commission has adequate oversight responsibilities and a lot of experience  
10 regarding the Low Income Usage Reduction Program ("LIURP"). WRAP is PPL  
11 Electric's LIURP program. With respect to LIURP, the Commission has  
12 promulgated regulations, developed a codebook, established reporting  
13 requirements and conducted periodic meetings to discuss LIURP developments  
14 and changes. Commission regulations also required that an independent, third  
15 party evaluate utilities universal service programs, including LIURP, at least  
16 every six years.

17 Second, most utilities, including PPL Electric, work closely with their  
18 weatherization contractors regarding the ongoing implementation of the program  
19 and the introduction of new features. For example, PPL Electric has collaborated  
20 with its WRAP contractors regarding energy conservation education,  
21 weatherization standards and benchmarks, various pilots (e.g., baseboard  
22 replacement, air conditioning and horizontal axis washing machine), field  
23 standards and training. In addition, the Company meets regularly with WRAP

1 contractors to discuss kWh savings results, program results and policy issues  
2 and conducts an annual meeting for all WRAP contractors.

3 Finally, WRAP is a mature program and has been providing  
4 weatherization services to low-income families since 1985. There have not been  
5 that many revolutionary changes regarding the measures and technology  
6 associated with the fundamentals of providing weatherization services. With  
7 respect to the changes that have occurred (e.g., blower-door testing, combustion  
8 testing and mold/mildew problems), PPL Electric and the WRAP contractors  
9 have kept abreast of these developments. In addition to providing specialized  
10 training when needed, PPL Electric sends its personnel and WRAP contractors  
11 to a well-respected national meeting (Affordable Comfort Conference) to learn  
12 about recent trends or developments regarding weatherization techniques,  
13 technology and evaluation.

14  
15 Q. Has PPL Electric identified any other issues or concerns regarding either  
16 OnTrack or WRAP?

17 A. Yes, Witness Colton recommends that funding for universal service programs  
18 come from all classes of customers and not just the residential class. Mr. Colton  
19 also suggests that PPL Electric should normalize OnTrack costs over a period of  
20 two years rather than eight years because the Company plans to file for another  
21 rate increase. Witness Weakley proposes to "levelize" the OnTrack expense  
22 allowance of \$13.2 million for a period of two years. With respect to the first  
23 issue, Witness Colton argues that funding for OnTrack is similar to a "public

1 good" in that all classes of customers receive benefits. He suggests that  
2 universal service programs increase employee productivity which, in turn,  
3 contributes to higher profitability for businesses. Finally, Mr. Colton indicates that  
4 it is conceptually wrong to insist that the purpose of OnTrack is to reduce  
5 overdue receivables for low-income customers. From his perspective, the issue  
6 is whether the program generates benefits for all classes of customers.

7 PPL Electric disagrees with Witness Colton's recommendation regarding  
8 funding for the universal service programs. The Company believes it is  
9 appropriate only for residential customers to fund OnTrack and WRAP. The  
10 Company does not support the conclusion that a low-income program is the  
11 equivalent of a "public good." The Commission's CAP Policy Statement (52 Pa.  
12 Code § 69.261 and § 69.264) clearly indicates that programs like OnTrack are for  
13 low-income, payment-troubled customers. Given the specific and narrow focus  
14 of OnTrack, the Company does not believe that the program meets the generally  
15 recognized concept of a "public good." Witness Colton's assertion that universal  
16 service programs provide benefits to all customers in general and to small  
17 business customers in particular is not convincing to PPL Electric. One could  
18 argue that keeping electric rates as low as possible for small businesses helps  
19 make them more competitive, thereby allowing them to provide jobs to low-  
20 income households. Finally, in PPL Electric's 1998 Settlement Agreement, which  
21 underwent an exhaustive and thorough evaluation by all parties, they agreed that  
22 residential customers were the appropriate source of funding for the universal  
23 service programs. The Company believes this rationale still holds true today.

1           Regarding the issue of "normalizing" costs over a period of eight years  
2 and the proposal to "levelize" OnTrack costs for two years at an annual funding  
3 level of \$13.2 million, the Company disagrees with the recommendations offered,  
4 respectively, by Mr. Colton and Mr. Weakley. PPL Electric proposed a  
5 normalization period of six years: three years to ramp up expenditures (2005  
6 through 2007) and three years (2008 through 2010) to make up for the under  
7 expenditures during the ramp-up period. Ramping up expenditures over three  
8 years would promote a smoother transition to increased spending and would  
9 allow the OnTrack social service agencies to more easily absorb the additional  
10 work. The two-year period suggested by Mr. Colton and Mr. Weakley is too short  
11 and should not depend on whether PPL Electric files for another rate increase.  
12 Even if the Company were to file for another rate increase in two years, all  
13 parties would have the opportunity to revisit the three-year ramp-up period and  
14 offer recommendations for changes. If the Commission approved Witness  
15 Weakley's proposal but PPL Electric did not file for a base rate increase within  
16 two years, fewer eligible customers (i.e., approximately 1,500 families annually)  
17 would receive OnTrack benefits. PPL Electric recommends a maximum of \$14.7  
18 million in annual funding for OnTrack, whereas Mr. Weakley suggests \$13.2  
19 million -- a difference of \$1.5 million. At an average annual cost of \$998 per  
20 customer, OnTrack would serve less eligible customers under Witness Weakley's  
21 proposal (i.e.,  $\$1,500,000/\$998 = 1,503$  households).

22           Witness Epstein recommends that PPL Corporation should use  
23 shareholder funding to match the proposed funding increases for both OnTrack

1 and WRAP. The Company disagrees with this suggestion for several reasons.  
2 First, there is nothing in PPL Electric's 1998 Settlement Agreement about  
3 requiring funding from shareholders for OnTrack or WRAP. Second, the  
4 Commission's regulations regarding universal service programs are silent on  
5 shareholder funding for Customer Assistance Programs (OnTrack) and the Low  
6 Income Usage Reduction Program (WRAP). Finally, the Company believes it  
7 has identified the appropriate level and source of funding for both programs.

8 Mr. Epstein expresses concern about the apparent drop in WRAP funding  
9 from 2007 through 2009. The Company has proposed to increase the WRAP  
10 budget from \$5.7 million to \$6.7 million and to ramp up the additional \$1 million in  
11 WRAP spending over a period of three years (2005 through 2007). However, the  
12 Company would begin collecting the full \$1 million from customers in 2005. As a  
13 result of the ramp up of expenditures, PPL Electric would under spend in the first  
14 three years (2005 through 2007) and overspend in the next three years (2008  
15 through 2010). The WRAP budget evens out at the proposed level of \$6.7  
16 million in 2011.

17 Witness Epstein notes that PPL Electric's administrative cost for WRAP is  
18 out of balance and needs a downward adjustment. The Company attempts to  
19 keep administrative costs for WRAP at 15 percent or lower. PPL Electric  
20 disagrees with Mr. Epstein's assertion that the projected administrative costs for  
21 WRAP from 2005 through 2007 average almost 20 percent. The Company has  
22 estimated the administrative costs at 15 percent for each year (e.g.,  
23 \$900,000/\$6.0 million, \$975,000/\$6.5 million and \$1,005,000/\$6.7 million).

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Q. Does the Company have any concerns with the witnesses' recommendations and comments regarding Operation HELP?

A. Yes, Witness Colton recommends that PPL Electric be required to submit to the Commission, ninety days after the disposition of the rate case, a detailed work plan through which the Company would increase donations to Operation HELP by 20 percent. PPL Electric disagrees with this recommendation for several reasons. First, as a threshold matter, Operation HELP is a voluntary program not reflected in customers' rates. The scope and size of Operation HELP are matters for PPL Electric to determine. Second, it is unreasonable to expect that the Company could increase donations to the program by 20 percent. Operation HELP is a long established program (begun in 1983) that, after 20 years of continuous operation, is probably nearing the saturation point on the number of monthly contributors. Third, it is important to remember the purpose of Operation HELP. The Company started the program as a way to help customers who were low income but not income eligible for LIHEAP. This supplemental program could provide aid to working poor families or assist customers when LIHEAP benefits were no longer available. It was never PPL Electric's purpose to grow Operation HELP into a program that would address a broad range of needs.

Fourth, the program is supported totally by donations. PPL Electric is proud of what the program has accomplished over the years (i.e., \$13.5 million in donations and 52,000 customers assisted), and the Company attributes a lot of the success to the strong support received from customers. Even though PPL

1 Electric enjoys a high level of customer satisfaction and loyalty, it is unrealistic to  
2 expect a significant increase in the level of customer donations. Fifth, the  
3 reasons why individuals contribute money for charitable purposes are varied and  
4 complex. A variety of external (e.g., state of the economy) and internal (e.g.,  
5 personal values) factors could affect contributions. Simply asking people more  
6 often to give money may not produce the expected results.

7 Finally, PPL Electric is very concerned about the customers  
8 (approximately 18,000) who have contributed faithfully over the years to  
9 Operation HELP via their electric bills. Conducting an aggressive fund-raising  
10 campaign immediately after an increase in rates could have a negative effect on  
11 current or potentially new contributors. Customers could view such a campaign  
12 as being too self-serving and needed only because the Company has increased  
13 its rates.

14  
15 Q. Does PPL Electric have other concerns regarding Operation HELP?

16 A. Yes, Witness Colton indicates that customer donations to Operation HELP have  
17 fallen from 2001 through 2003 even though the number of residential customers  
18 has increased during this same period of time. The Company is not convinced  
19 there is any relationship between the number of Operation HELP contributors  
20 and the number of residential customers. The reasons for contributing are  
21 complex and may have nothing to do with an increase in the number of  
22 customers. Furthermore, the increase in total residential customers was very  
23 modest over this three-year period (2.5 percent), which would tend to mitigate

1 any impact on the number of new contributors.

2 Mr. Colton notes that PPL Electric has consistently fallen short by 15  
3 percent of its goal to raise \$440,000 annually in donations from its customers,  
4 employees and retirees. The Company disagrees with this conclusion. The  
5 following table shows that PPL Electric has been achieving its fund-raising  
6 objective for customers, employees and retirees over the past three years.

7

Year	Funds Raised	% of Goal
2001	\$450,348	102.4%
2002	\$436,307	99.2%
2003	\$430,530	97.8%
<b>Total</b>	<b>\$1,317,185</b>	<b>99.8%</b>

8

9 Witness Colton also recommends an increase in the level of support from  
10 shareholders. PPL Corporation, through its Public & Charitable Contributions  
11 budget, has provided \$440,000 annually in funding to Operation HELP for the  
12 past several years. This amount matches the fund-raising objectives established  
13 by PPL Electric for annual donations from its customers, employees and retirees.  
14 PPL Corporation does periodically evaluate the level of shareholder funding for  
15 Operation HELP and has increased the amount (e.g., from \$120,000 in 1986 to  
16 \$300,000 in 1990 to \$325,000 in 1994).

17 Witness Colton, in his recommendation to have PPL Electric increases  
18 Operation HELP donations by 20 percent, suggested that new fund-raising  
19 strategies for hardship funds include seeking regular contributions from  
20 customers rather than one-time donations and allowing customers to give to the  
21 hardship fund on-line. Since the start of Operation HELP in 1983, PPL Electric

1 encouraged customers to give to the program via their electric bills.  
2 Approximately 18,000 customers give monthly to Operation HELP in this manner.  
3 The Company requests customers to give \$1, \$2, or \$5 monthly, but the flexibility  
4 of its information system allows customers to give any amount for any specified  
5 period of time within a year (e.g., \$10 monthly from November through March).  
6 Customers who pay on-line have the ability to contribute to Operation HELP.

7           Witnesses Brady and Howat recommend that PPL Electric should allocate  
8 Operation HELP funds on a more equitable basis. The Company allocates  
9 funding based on several factors: low-income population, expenditure trends of  
10 the administering agencies and overall customer needs in the various operating  
11 areas. The Company does not look at individual agencies or counties when  
12 allocating Operation HELP funds. Rather, PPL Electric considers the aggregate  
13 funding needs of an area (e.g., the Company's northeast area includes Hazleton,  
14 Scranton, Wilkes-Barre and Honesdale). The Company does look at the needs  
15 of each area annually and, when appropriate, will adjust funding levels. PPL  
16 Electric attempts to offer funding that matches areas' needs while ensuring that  
17 all Operation HELP agencies receive a meaningful amount of funding.

18           Witness Epstein recommends that PPL Electric should match ratepayer  
19 contributions to Operation HELP. The Company would like to note that  
20 donations to the program are truly donations because there are no rate charges  
21 for Operation HELP. For several years PPL Corporation has provided \$440,000  
22 in funding from shareholders for Operation HELP. The amount of annual  
23 customer donations to the program has averaged approximately \$379,000 over

1 the past four years. In other words, the Company's annual donation has  
2 exceeded that of customers.

3  
4 Q. Do you have any final issues you would like to address regarding the witnesses'  
5 testimony on universal service programs?

6 A. Yes, I would like to respond to concerns raised by Witnesses Brady and Howat.  
7 Mr. Brady asserts that PPL Electric is not qualified to design and implement  
8 universal service programs. As such, that responsibility should lie solely with  
9 community-based organizations like the Commission on Economic Opportunity.  
10 Furthermore, because PPL Electric is not accountable to the communities it  
11 serves and is conflicted by a duty to shareholders, the CBOs are singularly suited  
12 to speak on behalf of communities' needs. Witness Brady also implies that the  
13 *Company implements these programs only for public relations purposes.*

14 PUC regulations at 52 Pa. Code § 54.74 require utilities to submit  
15 Universal Service and Energy Conservation Plan every three years for  
16 Commission review and approval. Witness Howat recommends that PPL Electric  
17 be required to have community-based organizations meet with the Company,  
18 make written proposals and provide formal comments regarding the three-year  
19 plan. Mr. Howat also suggests that the Commission require PPL Electric to  
20 attach the CBOs' comments to its submission of the plan.

21  
22 Q. What are your concerns with the recommendations of Witnesses Brady and  
23 Howat?

1 A. PPL Electric takes exception to the assertion that it lacks the expertise to develop  
2 and implement customer programs. The Company has decades of experience in  
3 these areas and has a very successful track record of implementation. The  
4 ultimate responsibility and accountability for expenditure of customer funds lies  
5 solely and correctly with PPL Electric and not with non-profit organizations.  
6 Nevertheless, the Company has worked extensively with CBOs for many years to  
7 implement and improve low-income programs and will continue to do so. The  
8 Company also objects to the conclusion that CBOs are best suited to speak on  
9 behalf of customer needs because PPL Electric is conflicted by responsibilities to  
10 shareholders. Whereas the CBOs involved in universal service programs have a  
11 narrow focus (e.g., low-income households), PPL Electric has a broad focus that  
12 encompasses a variety of areas (e.g., economic development, community  
13 betterment, low-income customers, reliability of service, safety and  
14 environmental). As part of their regular jobs or as volunteers in a myriad of  
15 activities, PPL Electric employees are involved in their local communities.

16 The fact that PPL Corporation dutifully addresses the needs of  
17 shareholders and achieves certain financial milestones allows the Company to  
18 support activities in local communities. Finally, PPL Electric has implemented its  
19 universal service programs for the primary purpose of addressing the needs of  
20 customers. Any public relations' benefits that the Company may have received  
21 as a result of these programs are more by accident than by design. PPL Electric  
22 has not conducted any advertising campaigns to tout its involvement in low-  
23 income programs.

1           The Company believes that the Commission has sufficient oversight  
2 regarding the development of the three-year plans for universal service  
3 programs. Mr. Howat's suggestion would require the Commission to change its  
4 regulations, which PPL Electric believes is unnecessary and unwarranted. The  
5 Company suggests that making changes to these regulations, which affect all  
6 jurisdictional electric and gas utilities, during a rate case proceeding for a specific  
7 utility is an inappropriate venue.  
8

9                                   IV. PPL Electric's Responses to Recommendations  
10   Re: Sustainable Energy Fund

11 Q.     What are the positions and perspectives of the various witnesses regarding the  
12 Sustainable Energy Fund ("SEF" or "Fund")?

13 A.     There is a clear polarization of positions among the various witnesses regarding  
14 the continuation of funding for the SEF. Witnesses Prisco, Baron and Gruber all  
15 recommend the cessation of funding, while Witnesses Hanger, Schwarz, Link,  
16 Howat and Brady express support for continued funding with some caveats. For  
17 example, Witness Hanger suggests a doubling of funding for the SEF, Witness  
18 Schwarz proposes that the Pennsylvania Energy Development Authority  
19 ("PEDA") manage the SEF and Witnesses Howat and Brady recommend that the  
20 SEF allocate 36 percent of its annual funding for a residential photovoltaic ("PV")  
21 program. Witness Link proposes that the Commission set standards for the  
22 Fund, including compensation for Board members.  
23

24 Q.     What is PPL Electric's recommendation regarding the Sustainable Energy Fund?

1 A. PPL Electric is proposing a compromise position that would allow funding for the  
2 SEF to continue using the existing funding mechanism (i.e., .01 cents per kWh  
3 for all power sold to all customers) for a period of five years ending December  
4 31, 2009.

5  
6 Q. What are the Company's concerns regarding various recommendations to stop  
7 all customer funding of the SEF?

8 A. Witness Prisco suggests eliminating funding for the SEF because the program  
9 does not support life cycle cost effective conservation measures that are included  
10 in Executive Order 13123, Section 203. PPL Electric disagrees with this  
11 conclusion because the types of projects funded by the SEF include a variety of  
12 activities (e.g., wind development, green building and emerging electric  
13 technologies). PPL Electric agrees with Witness Prisco's assertion that the SEF  
14 has adequate funding to sustain operations for several more years. However,  
15 that conclusion misses the point. What is important is that the SEF evolve into a  
16 viable and fully sustainable entity. The Fund focuses on issuing loans, making  
17 equity/royalty investments and providing grants on a limited basis. The SEF has  
18 made investments that are returning money on a regular basis, but it usually  
19 takes several years to realize the biggest returns. Fledging companies normally  
20 need time to establish themselves and the SEF is no different.

21           Witnesses Baron and Hanger assert that PPL Corporation's shareholders  
22 and not distribution customers have actually paid for the SEF. PPL Electric  
23 disagrees with this assertion. The language of the Company's 1998 Settlement

1 Agreement stated that the SEF would be funded from the distribution charges in  
2 each rate schedule at the rate of .01 cents per kWh on all power delivered to all  
3 customers. Clearly, the Commission intended that all customers fund the SEF  
4 through their distribution charges. The Company has tariff language approved by  
5 the Commission regarding the use of a portion of distribution charges for all  
6 customers to pay for the SEF. The funding mechanism for the SEF underwent  
7 comprehensive discussion, review and approval by all parties during PPL  
8 Electric's 1998 Settlement Agreement.

9           Witness Baron argues that the SEF is not a cost of providing distribution  
10 services; the SEF is a research and development fund that does not enhance the  
11 distribution system; and the SEF supports supply-side projects that violate cost  
12 allocation and rate making principles for distribution charges. PPL Electric  
13 disagrees with this conclusion. The SEF has provided funds to a variety projects  
14 that would provide benefits to all facets of electric service. For example, the SEF  
15 has provided funding for projects over a variety of areas ranging from the Bear  
16 Creek wind energy project near Wilkes-Barre to the certified green building  
17 project for the Londonderry School in Harrisburg to PowerWeb Technologies,  
18 Inc. for software development of internet load management applications. Since  
19 all customers pay distribution charges, the Company believes it is appropriate to  
20 assign SEF costs to all classes of customers.

21           Mr. Baron states that the purpose of the Competition Act ("Act") was to  
22 deregulate energy supply and to allow customers to shop for alternative energy  
23 supply. Witness Baron asserts that the Commission is reintroducing regulatory

1 mandates on generation service by forcing distribution customers to subsidize  
2 the SEF. PPL Electric believes that Mr. Baron's characterization of the purpose  
3 of the Act is too narrow. The Act addressed other important issues regarding the  
4 quality of customer service, availability of programs and services and the  
5 continuation of programs for low-income customers. The Company disagrees  
6 with Mr. Baron's assertion regarding the reintroduction of regulatory mandates on  
7 generation service by the Commission. As noted earlier by PPL Electric, all  
8 customers pay for the SEF through their distribution rates, which the Commission  
9 approved as a result of the 1998 Settlement Agreement.

10           Witness Gruber asserts that continuing the funding of the SEF is  
11 tantamount to a hidden tax because the state budget contains funding proposals  
12 for environmental issues. From the Company's perspective, there is nothing  
13 hidden about the recommendation to continue funding for the SEF. PPL Electric  
14 believes that the SEF is serving an important niche market (i.e., renewable  
15 energy technologies and energy conservation and efficiency) with a focus that  
16 does not exist with other governmental or private entities. If the SEF were able  
17 to leverage state funding to expand its projects and reach, then benefits would  
18 accrue to PPL Electric's customers and communities.

19  
20 Q. Has PPL Electric identified any concerns or issues regarding the  
21 recommendations of those witnesses who support the continuation of funding for  
22 the SEF?

23 A. Yes, PPL Electric does not support Witness Hanger's recommendation to double

1 the funding for the SEF from .01 cents per kWh to .02 cents per kWh. The  
2 Company agrees with Mr. Hanger that there are opportunities for more work in  
3 the area of renewable energy technologies and energy conservation and  
4 efficiency but disagrees on the source and level of the funding. Witness Hanger  
5 reluctantly admits that meaningful taxpayer funding for renewable energy  
6 programs is not forthcoming. As a result, the primary funding sources for these  
7 activities must perforce come from utilities and ratepayers. The fact that most  
8 state legislatures do not consider renewable energy as a critical public policy  
9 issue (i.e., using taxpayers dollars to support programs) is a telling sign. Using  
10 electric utilities as "government by other means" may not result in the best,  
11 overall public policy.

12 Nevertheless, PPL Electric recognizes the difficulties presented by the  
13 competing needs and priorities for state funding and the importance of  
14 addressing environmental issues in a sustained manner. As such, the Company  
15 has proposed to continue funding the SEF for another five years. PPL Electric  
16 does not believe it is fair or equitable to have ratepayers, particularly low-income  
17 households, carry indefinitely the bulk of the funding load for expanding  
18 renewable energy activities. The Company's proposal would provide meaningful  
19 funding, allow the SEF to further establish its sustainability and minimize the cost  
20 impact on customers.

21 Witness Hanger states that he is unaware of any requirement (e.g., PUC  
22 Order) "... that imposes any assumption that PPL/customer funding for SEF  
23 "should" expire..." In the Joint Petition for Full Settlement of PP&L Inc.'s

1 Restructuring Plan and Related Court Proceedings, at Docket No. R-009973954,  
2 dated August 12, 1998, the Commission approved funding for the SEF that  
3 began on January 1, 1999 and ended on December 31, 2004, or until the  
4 Commission established new distribution rates, whichever is longer. PPL Electric  
5 concludes from this provision of its Settlement Agreement that the Commission  
6 did establish a firm expiration date. As part of its proposal for new distribution  
7 rates, the Company is recommending the continuation of funding for the SEF.

8           Witness Schwarz stated that PPL Electric objected to responding to  
9 interrogatories submitted by the Office of Small Business Advocate ("OSBA")  
10 regarding SEF activities. The OSBA then submitted the interrogatories to the  
11 SEF and is awaiting a response from the Fund. The Company objected to the  
12 OSBA's interrogatories because they addressed SEF-specific issues (e.g.,  
13 detailed resumes of Board members and Board members' qualifications for  
14 investing in renewable energy technologies) best addressed by the Fund's  
15 management. The SEF responded to the OSBA's interrogatories on July 2,  
16 2004.

17           Mr. Schwarz's key recommendation is to turn over the management of the  
18 SEF to the Pennsylvania Energy Development Authority ("PEDA"). He bases his  
19 recommendation on several factors: PEDA has a mandate similar to the SEF;  
20 PEDA is charged with financial renewable energy projects; PEDA can provide  
21 better coordination of projects among the various SEFs; and PEDA can ensure  
22 greater accountability. PPL Electric has several concerns regarding this  
23 proposal.

1 First, Mr. Schwarz admits that PEDDA had been moribund and just recently  
2 the Governor issued an executive order transferring its responsibilities to the  
3 Department of Environmental Protection. In addition, PEDDA has not yet  
4 developed its procedures for selecting and funding projects. Given these  
5 developments, it seems premature to consider an expanded role for PEDDA  
6 regarding involvement with the SEF. Second, PPL Electric believes that the  
7 Commission has sufficient oversight responsibilities to ensure that the SEF meet  
8 the requirements of the Settlement Agreement. For example, the Commission  
9 approved the SEF's by-laws, approves new Board member and requires an  
10 annual audit and semi-annual reports. The SEF provides these reports to the  
11 Commission and parties from the 1998 Settlement Agreement. The Commission  
12 also has a Pennsylvania Sustainable Energy Board (PASEB) that is charged  
13 with:

- 14 • Offering guidance and technical assistance to the regional SEFs.
- 15 • Providing oversight in developing a best practices business model.
- 16 • Serving as a forum where the SEFs, Commonwealth agencies, public  
17 officials and others can learn more about sustainable energy technologies.

18 Third, the Company has concerns about a state agency directing and  
19 administering the expenditure of ratepayer funding. The SEF is not a tax-based  
20 program that the General Assembly debated, approved and allocated funds  
21 toward. PPL Electric would not support the expenditure of a majority of customer  
22 funds in areas outside of its service territory. The Company's SEF is an  
23 entrepreneurial entity that has a solid track record of accomplishment and has

1 worked hard to establish its sustainability. The SEF must have accountability  
2 and oversight, which PPL Electric believes the Commission has provided, but the  
3 Fund also needs the flexibility to identify projects and to move quickly and  
4 prudently when needed. Adding another layer of bureaucracy and control does  
5 not seem desirable.

6 PPL Electric certainly agrees that the Commission, PASEB, PEDDA and the  
7 various Sustainable Energy Funds should work collaboratively to promote a  
8 sustainable energy future for Pennsylvania. The Company also agrees that there  
9 are opportunities to improve the coordination of the Funds and to share best  
10 practices. However, the Company is not convinced that PEDDA should assume  
11 the coordination mantle for Pennsylvania's SEFs.

12 Witness Schwarz expressed concern that the PUC-required annual audit  
13 and reports did not provide information on the selection criteria for SEF projects.  
14 Mr. Schwarz noted that the SEF resisted the reasonable requirement to explain  
15 why the Fund rejects proposals. The SEF, of course, has a detailed and  
16 standardized process for evaluating funding proposals. The SEF staff reviews all  
17 funding proposals received to determine if the project warrants further  
18 investigation. If the project shows promise, the staff conducts an evaluation that  
19 includes, but is not limited to, costs, leveraging opportunities, associated risks  
20 and the fit with the SEF's mission. After this assessment, the SEF staff reviews  
21 the project proposal with a Board Committee charged with evaluating funding  
22 proposals. If approved by this Committee, the full Board reviews the project  
23 proposal and votes on whether to provide funding. The SEF rejects projects that

1 do not meet the evaluation criteria.

2  
3 Q. Do you have any other concerns about the witnesses' recommendations for the  
4 SEF?

5 A. Yes, witnesses Brady and Howat recommend that the Commission should  
6 mandate 36 percent of the SEF's annual funding toward a photovoltaic ("PV")  
7 grant program for all residential customers. Based on the SEF's funding from  
8 2002, that percentage translates into approximately \$1.2 million. Witness Howat  
9 proposes that the SEF allocate 17.6 percent to low-income customers and 82.4  
10 percent to all other residential customers. Approximately 17.6 percent of  
11 residential customers have annual household incomes at or below 150 percent of  
12 the federal poverty level. Mr. Howat suggests a 100 percent grant program for  
13 low-income customers and a one-to-one matching grant for other residential  
14 customers. The four community-based organizations that participated in PPL  
15 Electric's renewable energy pilot for low-income customers would handle all  
16 facets of this proposed program (e.g., review PV grant applications, review  
17 systems and inspect installations).

18 PPL Electric agrees that the SEF should be more involved in identifying  
19 and implementing renewable energy projects for residential customers. This is  
20 an area where the SEF could expand its activities. However, the Company does  
21 not agree with allocating a set percentage of funding toward any class of  
22 customer or any type of specific activity. First, there is nothing in PPL Electric's  
23 Settlement Agreement regarding the allocation of funding to certain classes of

1 customers. Second, the SEF should have the flexibility to use its funding for  
2 projects that provide the best value for the dollars invested. Designating funding  
3 for a specific technology (e.g., photovoltaic applications) may prevent the SEF  
4 from realizing greater benefits for customers in other areas of renewable energy  
5 technologies. Finally, the Company is not convinced that providing grants to  
6 residential customers for photovoltaic installations is the appropriate use of  
7 funding.

8 For example, the payback period for residential photovoltaic applications  
9 is, at best, approximately 30 years. Preliminary estimates for PPL Electric's  
10 photovoltaic pilot participants are not encouraging. The average installation cost  
11 of each PV unit for the Company's pilot was over \$10,000. The Company  
12 expects these systems to reduce a customer's annual electric bill by \$136 (1,000  
13 watts x 4.3 solar hours per day x 8.5 cents per kWh x 31 days x 12 months).  
14 Under the Company's current rates, this equates to an average payback period  
15 exceeding 70 years. Even with increased rates the payback period would still be  
16 very lengthy.

17 Other challenges include finding suitable homes for PV installations (e.g.,  
18 roof orientation and no shade trees), obtaining reliable equipment, maintaining  
19 the systems and securing permission from landlords for installations. In PPL  
20 Electric's pilot there was a major problem with the failure of inverters, which  
21 change direct current into alternating current. The manufacturer eventually went  
22 out of business. In the Company's regular weatherization program (i.e., WRAP),  
23 approximately 30 percent of landlords refuse to give their permission to install

1 materials. It might be different if PV was a relatively new and developing  
2 technology that warranted further testing; however, PV technology has been  
3 around for years and has not proven to be cost effective for most residential  
4 applications. With a proposed budget of \$1 million, the community-based  
5 organizations ("CBOs") would have to install around 100 units annually. Given  
6 PPL Electric's experience with its renewable energy pilot, in which the CBOs  
7 struggled to identify and install 44 units, it would be difficult for the agencies to  
8 complete 100 units annually.

9           Witness Howat recommends the expeditious use of SEF funding in the  
10 community and asserts that the Fund is holding dollars for its own financial gain.  
11 Mr. Howat further suggests that the SEF's Board of Directors ("Board") include a  
12 representative from a CBO that serves the low-income population. With respect  
13 to the issue of expending funds, the SEF early on was determined to operate in a  
14 sustainable manner. The Fund decided not to allocate all of its funding as  
15 grants; rather, the SEF focused on issuing loans and making equity/royalty  
16 investments. The Board also reserved funds in investment accounts so that  
17 there would be funds available beyond December 31, 2004. The Fund hired third  
18 parties to manage the funds. As a supporting organization for a non-profit 501-  
19 C(3) entity, it is clearly prudent and proper for the SEF to be a careful steward of  
20 its funding. Approving loans, taking equity positions and issuing grants is an  
21 ongoing process for the SEF that involves a variety of steps. Among the various  
22 Funds in Pennsylvania, the SEF for PPL Electric has the best track record  
23 regarding the implementation of projects and the Fund continues to make

1 progress. In 2004, the SEF has estimated expenditures of approximately \$3.3  
2 million (i.e., 90 percent in loans/equity investments and 10 percent grants).

3 *Regarding the issue of having a low-income advocate on the SEF's Board,*  
4 *one of the original Board members, Mr. Alan Jennings, ably represented the*  
5 *interests of low-income organizations. Mr. Jennings is the Executive Director of*  
6 *the Community Action Committee of the Lehigh Valley, which is an organization*  
7 *very similar in purpose and focus to the Commission on Economic Opportunity.*

8 *PPL Electric agrees with Witness Link's recommendation for the*  
9 *Commission to set standards for the SEF. The Company believes that the*  
10 *Commission's Pennsylvania Sustainable Energy Board ("PASEB") is fulfilling this*  
11 *function by developing "best practices" in a variety of areas (e.g., project*  
12 *evaluation, reporting and compensation for Board members) for all of the Funds*  
13 *in the Commonwealth. The Commission has further oversight responsibilities*  
14 *that include approving the Fund's by-laws, reviewing and approving Board*  
15 *members and requiring an annual audit and semi-annual reports.*

16  
17 Q. Do you have any other comments or observations about the SEF?

18 A. *Recognizing the strong opinions held by parties on both sides of the issue*  
19 *regarding continued funding for the SEF, PPL Electric has attempted to offer a*  
20 *compromise position that it believes is balanced and fair. The Sustainable*  
21 *Energy Fund has a specific mission to achieve and no other state agency or*  
22 *government exists with the same focus. State agencies have supported SEF*  
23 *project initiatives, but in most of these projects the SEF has been the driving*

1 force for implementation.

2 The continuation of the Fund supports broad public policy objectives  
3 regarding the environment, establishes partnerships with government to address  
4 environmental needs, promotes the development of renewable energy  
5 technologies and helps to achieve a cleaner environment over the long run. The  
6 Company believes that the SEF provides benefits to all classes of customers.  
7 Survey research has shown that environmental issues are important to  
8 customers and community leaders. From PPL Electric's perspective, the whole  
9 arena of renewable energy technologies is still an evolving industry in  
10 Pennsylvania. As such, the SEF needs additional time to further enhance its  
11 capabilities, pursue new areas of environmental interest and expand its working  
12 relationships and coordination with state government and other partners.

13  
14 V. PPL Electric's Responses to Recommendations  
15 Re: Community Betterment Initiative

16 Q. What has PPL Electric proposed regarding the Community Betterment Initiative  
17 ("CBI")?

18 A. The CBI would assist community development organizations and human service  
19 agencies in addressing local needs by providing grant funds that would leverage  
20 matching funds from the state for targeted programs (e.g., economic  
21 development and affordable housing). PPL Electric recommends \$2 million in  
22 annual funding for the program -- \$1 million from customers and \$1 million from  
23 PPL Corporation's shareholders.

1 Q. What are the witnesses' recommendations and concerns regarding the  
2 Community Betterment Initiative?

3 A. Witness Prisco proposes to eliminate the \$1 million in ratepayer funding for the  
4 CBI because the Company is already supporting conservation-oriented social  
5 programs and customers should be able to choose what charitable programs  
6 they would like to support. Witness Epstein endorses the CBI but recommends  
7 that PPL Electric should match ratepayer funding for the program. Witness  
8 Howat supports the CBI as proposed by the Company but recommends a formal  
9 review process to oversee allocation of the funds and that the process should  
10 include input from all relevant stakeholders. Witness Colton endorses the CBI  
11 because the program would help address the need for universal service  
12 programs and the costs of collections. Generating matching public and private  
13 matching funding through the CBI would generate benefits for ratepayers as well.

14  
15 Q. *What are the Company's concerns regarding the recommendations of the*  
16 *various witnesses?*

17 A. PPL Electric disagrees with Witness Prisco's recommendation to eliminate  
18 ratepayer funding for the Community Betterment Initiative. The Company clearly  
19 has a vested interest in supporting economic and community development  
20 efforts. More jobs, a sounder economy and strengthened communities provide  
21 benefits to many. Survey research consistently shows that economic  
22 development is one of the top priorities of local communities. Elected and  
23 appointed officials and other community leaders view PPL Electric as a vital and

1 necessary partner. The ability of the CBI to more effectively access state funds  
2 would be of great value to projects in local communities, especially with the  
3 introduction of many new initiatives in the Economic Stimulus Package. A study  
4 conducted by third party evaluators of PPL Electric's very successful Community  
5 Partnership Program, which had similar features to the proposed CBI, showed a  
6 return of over \$20 to local communities for every \$1 invested. The Company  
7 also recognizes that it takes effective partnerships to address community needs  
8 and concerns.

9           The CBI would promote and enhance a variety of partnerships among  
10 community organizations, state agencies and PPL Electric, especially those that  
11 emphasize themes of focusing development in appropriate places. From the  
12 Company's perspective, a modest and reasonable amount of investment in  
13 supporting the needs of local communities would provide solid returns to many  
14 parties. The strengthened public-private partnerships would enhance the  
15 communities' and the Commonwealth's reputation as places where sound  
16 planning and cooperation produce results. New programs such as Business in  
17 Our Sites and Keystone Innovation Zones that rely on such partnerships can be  
18 more successful in PPL Electric's communities with the resources that CBI would  
19 make available.

20           PPL Electric agrees with Witness Epstein's recommendation to match  
21 ratepayer funding for the CBI. The Company has proposed to provide \$1 million  
22 in shareholder funding for the program. However, the implementation of the CBI  
23 by PPL Electric is contingent upon approval by the Commission of \$1 million in

1 annual funding from ratepayers.

2 The Company disagrees with Witness Howat's proposal to establish a  
3 formal review process for allocation of funding for CBI projects that includes input  
4 from all relevant stakeholders. First of all, PPL Electric sees a major conflict of  
5 interest in having potential CBI grantees involved in the review and approval  
6 process. The Company would conduct information meetings with community  
7 organizations to explain the purpose of the CBI, its requirements, timeline, etc.  
8 All interested parties would have an equal opportunity to apply for and receive  
9 CBI grants.

10 Secondly, the Company would develop an internal review and approval  
11 process for the program that would include the appropriate evaluation criteria.  
12 PPL Electric would establish an internal team to ensure a thorough and objective  
13 review of CBI proposals. An important decision-making criterion for this team  
14 would be a proposal's compliance with an effective local development plan and  
15 strategy. Stakeholders would have provided input through their participation in  
16 the development and implementation of these local plans.

17 *Thirdly, in addition to the conflict of interest concern, the Company*  
18 *believes that it would be impractical and unwieldy to involve all relevant*  
19 *stakeholders, which could number in the hundreds. It would be even more*  
20 *difficult to select a representative sample of community organizations to provide*  
21 *suggestions on the allocation of funds. Which organizations would be included*  
22 *and why? Finally, PPL Electric has years of experience in evaluating and*  
23 *awarding grants to organizations involved in economic and community*

1 development activities. The review and approval process that the Company  
2 established for the Community Partnership Program (1995 -1997) worked  
3 effectively.

4

5 Q. Does this conclude your rebuttal testimony?

6 A. Yes, it does.

Statement No. 9-R

DOCUMENT

**PPL ELECTRIC UTILITIES CORPORATION**

Rebuttal Testimony

of

Paul R. Moul, Managing Consultant  
P. Moul & Associates

DOCKETED

JUL 28 2004

Concerning  
Rate of Return

**PPL Electric Utilities Corporation**

Rebuttal Testimony of Paul R. Moul  
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## REBUTTAL TESTIMONY OF PAUL R. MOUL

1

### I. Introduction

2 **Q. Please state your name, occupation and business address.**

3 A. My name is Paul R. Moul and I am Managing Consultant of the firm P. Moul &  
4 Associates. My business address is 251 Hopkins Road, Haddonfield, NJ 08033-3062.

5 **Q. Mr. Moul, have you previously submitted direct testimony in this proceeding?**

6 A. Yes. My direct testimony was submitted with the Company's case-in-chief on March  
7 29, 2004.

8 **Q. What is the purpose of your rebuttal testimony?**

9 A. PPL Electric Utilities Corporation ("PPL" or the "Company") has requested that I  
10 comment on and rebut the testimony presented by Mr. Matthew I. Kahal, a witness  
11 appearing on behalf of the Office of Advocate ("OCA"), Mr. Kenneth L. Kincel, a  
12 witness appearing on behalf of the Department of Defense ("DOD"), and Mr. Kevan L.  
13 Deardorff, a witness appearing on behalf of the Office of Trial ("OTS").

14

### II. Overview

15 **Q. Please provide an overview of the positions of the opposing parties in this case.**

16 A. As a preliminary matter, Mr. Deardorff and Mr. Kincel have accepted the Company's  
17 proposed capital structure ratios and embedded costs of senior capital. Mr. Kahal has  
18 also adopted some the components of the rate of return, but he has erroneously rejected  
19 the Company's future test year common equity projection. Aside from this single  
20 capital structure issue, the cost of equity is the only major item of dispute. In resolving  
21 the cost of equity in this case, it is important that the Commission address the  
22 following issues: (i) whether the cost of equity proposed by these witnesses, if  
23 adopted, adequately reflects capital costs during the rate effective period, (ii) the

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 determination of a reasonable Discounted Cash Flow (DCF) cost rate, (iii) whether an  
2 adjustment to the DCF is warranted because it understates the cost of equity under  
3 current market conditions, (iv) the extent to which other methods of determining the  
4 cost of equity provide a reasonable measure of the appropriate rate of return on  
5 common equity, and (v) whether adjustments are necessary to the cost of equity as  
6 measured with proxy group data when applied to the Company's common equity ratio.

7 It is disappointing to observe that none of the witnesses have recognized any increment  
8 for management efficiency for PPLEU as detailed in the direct testimony of Mr.  
9 Sipics. Further, these witnesses have ignored the initiatives taken by the Company to  
10 secure its POLR obligation and have refused to recognize that investors view the risk  
11 of electric distribution companies as equivalent to other utility groups. As discussed in  
12 the rebuttal testimony of Ms. J. M. Cannell, investors generally expect that the allowed  
13 return on equity will be in the range to 10% to 12%. Investors will be especially  
14 disappointed if Mr. Kahal's recommendation is accepted, and they will be shocked if  
15 Mr. Deardorff's recommendation were accepted. This could lead to a further  
16 deterioration of the business position of PPLEU and reduced credit quality because the  
17 quality and supportiveness of utility regulation is an important element of credit  
18 analysis.

19 **Q. Please identify some of the factors that contribute to the understatement of cost of**  
20 **equity proposed by these witnesses.**

21 A. The factors that contribute to the inadequate recommendations of the rate of return on  
22 common equity include the environment of low interest rates in recent years, and  
23 undue emphasis on the DCF model of the cost of equity -- Mr. Deardorff gives sole

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 weight to the DCF results and Mr. Kahal gives primary weight to the DCF results. As  
2 to the latter point, the Commission has recognized that the DCF results understate the  
3 cost of equity when market prices exceed book value. This point was acknowledged  
4 by Mr. Kincel, and was recognized as part of his cost of equity analysis. Since the  
5 constant growth assumption of the DCF is unlikely to be correct under current  
6 circumstances substantial weight must be given to other methods for determining the  
7 cost of equity. It is also somewhat perplexing that Messrs. Kahal and Deardorff gave  
8 little weight to projected dividend growth rates, especially with the change in taxation  
9 of dividends. This is in contrast to DOD witness Mr. Kincel who develops a 10.25%  
10 DCF cost rate using dividend growth, and then uses that result as the low end of his  
11 proposed range of the cost of equity, with the high end of his range consisting of an  
12 11.0% cost of equity determined using the CAPM. If the DCF cost rates for OCA  
13 witness Mr. Kahal and OTS witness Mr. Deardorff employed projected dividend  
14 growth rates, their DCF returns would be 10.29% and 9.72%/9.73%, respectively,  
15 computed without regard to the adjustment necessary to make those returns applicable  
16 to a book value capitalization.

17 **Q. Why, in your view, is the rate of return on common equity proposed by Messrs.**  
18 **Kahal and Deardorff too low?**

19 A. Among other reasons, the 9.50% and 8.75% rates of return on common equity being  
20 proposed by Messrs. Kahal and Deardorff do not adequately recognize higher capital  
21 cost rates that are expected by investors during the rate effective period.

22 **Q. What are the implications of emphasizing recent data taken from a period of**  
23 **relatively low interest rates?**

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 A. It appears obvious that if interest rates rise from their current levels, the cost of equity  
2 determined from recent data will understate future capital costs. Although it is always  
3 possible that interest rates could move lower, this possibility is out-weighed by the  
4 prospect of higher future interest rates. That is to say, there is more potential for  
5 higher rather than lower interest rates when the beginning point in the process contains  
6 relatively low interest rates.

7 The low interest rates in 2003-'04 were, in part, the product of the Federal  
8 Open Market Committee ("FOMC") policy, which is now in transition. Indeed, on  
9 June 30, 2004, the FOMC increased the Fed Funds rate, which is widely interpreted as  
10 the beginning of a series of rate increases. This was the first increase in the Fed Funds  
11 rate since May 16, 2000 and followed thirteen decreases over that period. As noted in  
12 The Wall Street Journal semiannual survey of more than 50 leading economists (see  
13 issue dated July 2, 2004), higher interest rates are forecast by the middle of 2005,  
14 which is reflective of a business environment of steady growth and rising corporate  
15 profits. Indeed, those forecasts show an increase in the yield on 10-year Treasury  
16 Notes from 4.56% at mid-year 2004 to 5.42% by June 2005 -- this represents an 86  
17 basis points increase in interest rates by the midpoint of the rate year (i.e., the first  
18 twelve month period after rates become effective).

19 **Q. Is there other evidence of higher interest rates for the future?**

20 A. Yes. The Blue Chip Financial Forecasts ("Blue Chip") is published monthly and  
21 contains consensus forecasts of a variety of interest rates compiled from a panel of  
22 banking, brokerage, and investment advisory services. I have provided below the Blue

REBUTTAL TESTIMONY OF PAUL R. MOUL

1 Chip yields on Aaa rated and Baa rated corporate bonds and the yield on 10-year and  
2 20-year Treasury obligations. These forecasts from the July 1, 2004 Blue Chip are:

3		Aaa-rated	Baa-rated	10-year	20-Year
4	<u>Quarter</u>	<u>Corporate</u>	<u>Corporate</u>	<u>Treasury</u>	<u>Treasury</u>
5	3rd Qtr. 2004	6.2%	7.0%	4.9%	5.6%
6	4th Qtr. 2004	6.4	7.2	5.1	5.8
7	1st Qtr. 2005	6.6	7.4	5.3	6.0
8	2nd Qtr. 2005	6.8	7.5	5.5	6.1
9	3rd Qtr. 2005	6.9	7.7	5.6	6.2
10	4th Qtr. 2005	7.0	7.8	5.8	6.3

12 **Q. Are there forecasts of interest rates that extend beyond those shown above?**

13 A. Yes. Twice yearly, Blue Chip provides a long-term forecast of interest rates. In its  
14 June 1, 2004 publication, the consensus forecasts of interest rates were forecast to be:

15		Aaa-rated	Baa-rated	10-year	Long-term
16	<u>Year</u>	<u>Corporate</u>	<u>Corporate</u>	<u>Treasury</u>	<u>Treasury</u>
17	2005	6.9%	7.7%	5.6%	6.1%
18	2006	7.3	8.0	5.9	6.5
19	2007	7.5	8.2	6.1	6.6
20	2008	7.6	8.3	6.2	6.7
21	2009	7.6	8.3	6.2	6.7
22	2005-09 (avg)	7.4	8.1	6.0	6.5
23	2010-14 (avg)	7.5	8.2	6.1	6.6

25 These forecasts show that interest rates will likely increase from current levels. Mr.  
26 Kahal's proposed 9.50% rate of return on common equity and a more onerous 8.75%  
27 rate of return on common equity proposal by Mr. Deardorff are inadequate to  
28 accommodate this increase in capital costs.

29 **Q. Can you demonstrate how the rate of return on common equity proposed by the**  
30 **witnesses representing the OCA and OTS are unusual in public utility**  
31 **ratesetting?**

**REBUTTAL TESTIMONY OF PAUL R. MOUL**

1 A. A further demonstration of the inadequacy of the 9.50% or 8.75% rate of return on  
2 common equity proposed by Messrs. Kahal and Deardorff is shown by reference to the  
3 rates of return being provided to energy utilities in other rate case proceedings. The  
4 PUR Utility Regulatory News ("URN") issue dated December 26, 2003 provides the  
5 results of the annual survey of regulatory authorized rates of return on common equity.  
6 The distribution of the returns were:

	<u>Number</u>	<u>Percent</u>
8 Less than 10%	5	12%
9 10% to 10.9%	13	30%
10 11% to 11.9%	19	44%
11 Higher than 12%	6	14%

12 The average authorized rate of return on common equity was 11.02%, the median  
13 return was 11.00%, and the midpoint return was 11.13%, taken from the overall range  
14 of 9.50% to 12.75%<sup>1</sup>. These data show that equity return allowances below 10% were  
15 uncommon for energy utilities in 2003, when projections of future interest rates were  
16 lower than they are now. Since forecasts of future interest rates are a generally higher  
17 now than they were in 2003, a determination of the cost of common equity that is  
18 below 10% in this proceeding would be clearly out of the range of reasonableness and  
19 likely would be regarded negatively by the market.

---

<sup>1</sup> The 2003 survey published in PUR Utility Regulatory News contained an apparent error where one return was erroneously reported as an equity return, when it was actually an overall rate of return. The tabulation shown above removes this apparent error. PUR Utility Regulatory News, December 26, 2003 (Letter #3649), at 2-5.

REBUTTAL TESTIMONY OF PAUL R. MOUL

1 III. Response to OCA Witness Kahal

2 Capital Structure

3 Q. Before proceeding with your discussion of the cost of equity, do you agree with  
4 the capital structure ratios that Mr. Kahal has proposed for PPLEU in this case?

5 A. No. Mr. Kahal seems to suggest that the Company's forecast of retained earnings for  
6 2004 is unrealistic, and, therefore, an earlier balance (i.e., December 31, 2003) should  
7 be used in its place. He makes this assertion based upon his analysis of the historical  
8 2002 and 2003 earnings and dividend payments and concludes that 2004 earnings will  
9 not be sufficient to pay dividends and grow retained earnings. Although the rate caps  
10 will preclude the Company from earning a reasonable rate of return in 2004, the  
11 Company does anticipate growth in retained earnings in 2004 due to the lack of  
12 unusual charges in 2004 relating to workforce reductions, a reduction in dividend  
13 payments from PPLEU to its parent company, and higher net income due primarily to  
14 higher sales.

15 Q. Is there adequate support for the Company's projection of the future test year  
16 retained earnings?

17 A. Yes. The Company's projection for the future test-year shows an increase of \$15.071  
18 million (\$318.762 million - \$303.691 million) in retained earnings. Through June 30,  
19 2004, the Company's actual results are slightly ahead of forecast. Indeed, earnings  
20 available for common equity were \$36 million for the six months through June 30,  
21 2004 and dividend payments were \$2 million for the first half of 2004. The Company  
22 has been managing its dividend payments in order to cover construction expenditures  
23 and sustain its credit quality. This means that the retained earnings account has

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 already grown by \$34 million (\$36 million - \$2 million) in the first six months of  
2 2004. During the second half of 2004, PPLEU anticipates paying the majority of its  
3 2004 dividends to its parent company, which is expected to result in 2004 retained  
4 earnings being slightly higher than the future test year projections as filed. Overall, the  
5 Company's future test year projection of retained earnings is reasonable and should be  
6 accepted.

### 7 Cost of Common Equity

8 **Q. Returning to the issue of the cost of equity, Mr. Kahal's claims that the 9.5%**  
9 **equity return that he proposes in this case is consistent with 11.5% equity return**  
10 **granted by the Commission in the Company's last rate case. Please respond.**

11 A. As a preliminary matter, I acknowledge that interest rates have declined since the time  
12 of the Company's last rate case. In 1995, the yield on A-rated public utility bonds was  
13 in the 8% to 9% range, or an 8.5% midpoint. Today, the yield on A-rated public utility  
14 bonds is approximately 6.25%. However, as I explained previously, interest rates are  
15 projected to rise and a reasonable estimate of the yield on Aaa-rated corporate bonds in  
16 2005 is in the range of 6.6% to 7.0%. The Commission's prior rate allowance in 1995  
17 would have been influenced by many factors including market and regulatory  
18 conditions and investor perceptions at that time and the likelihood that the risk  
19 premium over the cost of debt can vary over time. It is overly simplistic to think that  
20 the Commission can just update the prior cost of equity by the change in interest rates.  
21 For example, at the time of the Company's last rate case, the business position of  
22 PP&L was "average" (using a somewhat different scale than is used currently) when it  
23 was an integrated electric utility. Today, PPLEU, which is solely an electric delivery

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 utility, has business profile for "4," which places it near the midpoint of the entire  
2 spectrum covering profiles "1" to "10," and as I will explain later is at the high end of  
3 the range of risk for electric delivery utilities.

4 **Q. How do the recommendations by Messrs. Kahal and Deardorff compare to other**  
5 **cost of equity allowances provided by the Commission?**

6 A. It is quite apparent that the cost of equity proposals by Mr. Kahal (i.e., 9.5%) and by  
7 Mr. Deardorff (i.e., 8.75%) are substantially too low given the Commission's equity  
8 return allowance of 10.6% in January 2004 for Pennsylvania-American Water  
9 Company ("PAWC"). Likewise, the Commission determined that Aqua Pennsylvania,  
10 Inc. ("API") was entitled to a 10.6% cost of equity according to the motion dealing  
11 with that issue adopted at the Commission's public meeting on July 23, 2004. As  
12 illustrated later in my response to Mr. Deardorff, prospective interest rates were about  
13 0.5% lower and 0.3% lower, respectively, during the periods in which these cases were  
14 litigated as compared to today. Yet, Mr. Deardorff and Mr. Kahal propose  
15 substantially lower cost rates than those adopted by the Commission in these cases.

16 **Q. Do these rate case decisions for water utilities have any relevance to PPLEU,**  
17 **which provides electric delivery service?**

18 A. Yes. Utilities engaged in delivery service, regardless of whether they provide potable  
19 water, electricity, or natural gas share many risk traits. This is shown by comparing  
20 the business profiles assigned during the credit rating analysis process by Standard &  
21 Poor's Corporation ("S&P"). As noted in my direct testimony, the business profile  
22 risk scale of "1" to "10" indicates increasing business risk as the numerical values  
23 increase. Using the new S&P assignments announced on June 2, 2004, ninety-eight

**REBUTTAL TESTIMONY OF PAUL R. MOUL**

1 percent (98%) of all water, electric and natural gas delivery utilities have business  
 2 profiles within the range of “1” to “4.” On a comparative basis, the distribution of  
 3 those business profiles, as taken from the list provided on Exhibit PRM-2, is:

	<u>Business Profiles</u>			
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>
Electric	23%	17%	37%	23%
Water	8%	50%	25%	17%
Natural Gas	16%	47%	25%	6%
Combination E&G	-	-	80%	20%
All Regulated Delivery	16%	33%	33%	15%

5 These comparisons reveal two facts. First, there is little difference among utility  
 6 delivery companies, as a whole, whether they are engaged in the provision of potable  
 7 water, electricity, or natural gas. Second, PPLEU now has a “4” business profile,  
 8 which places the Company in the top quartile, or highest risk category of electric  
 9 delivery companies. It is also revealing that all but one of the electric delivery  
 10 companies in Pennsylvania have been assigned a “4” business profile. So while the  
 11 business risk does not differ appreciably among utility-types, PPLEU and other electric  
 12 delivery companies in Pennsylvania are near the top of the business risk spectrum.

13 **Q. Do the bond ratings of these utilities reveal a similar pattern?**

14 **A.** Generally, the credit quality is somewhat stronger for the water and natural gas utilities  
 15 than for the electric delivery utilities. Here, the comparisons, taken from the list  
 16 provided on Exhibit PRM-2, are:

	<u>Corporate Credit Rating</u>		
	<u>AA</u>	<u>A</u>	<u>BBB</u>
Electric	0%	40%	50%
Water	8%	92%	0%
Natural Gas	6%	56%	31%
Combination	-	60%	40%
All Regulated Delivery	4%	56%	34%

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 This comparison shows that the credit quality of the electric delivery utilities is below  
2 that of its other delivery utilities. Essentially, the bond rating reflects an assessment of  
3 both business risk (i.e., those revealed the profiles discussed above) and financial risk.  
4 The overall conclusion is that the electric delivery companies have generally  
5 somewhat higher credit risk.

6 **Q. How does this risk assessment impact the rate of return determination for**  
7 **PPLEU in this case?**

8 A. There are three elements that the Commission should incorporate in its final rate of  
9 return determination for PPLEU. First, the rate of return granted to an electric delivery  
10 utility should not be less than that established for other utilities -- including the cost of  
11 equity *determined for water utilities*. Second, PPLEU presently has a negative  
12 outlook. S&P has stated:

13 "The negative outlook reflects the still weak credits metrics and the  
14 uncertainty surrounding the outcome of the rate case, filed with the  
15 PUC in March 2004. Although the company expects new PUC  
16 rates to bolster its performance after 2004, if the new rates do not  
17 result in an improvement in credit ratios, the ratings on PPLEU  
18 will be lowered."  
19

20 Third, the generally low "4" business profile scores for electric delivery utilities in  
21 Pennsylvania shows that supportive regulation will be a key to maintaining the  
22 financial integrity of the electric delivery business in the Commonwealth.

23 **Q. Turning to some of the specific comments regarding the cost of equity, the**  
24 **opposing witnesses in this case have criticized your analysis that relied upon**  
25 **market evidence for natural gas utilities. Please respond.**

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 A. There are many parallels between the delivery of natural gas and electricity. However,  
2 in some important aspects of the business, electric delivery utilities in Pennsylvania are  
3 at a distinct disadvantage to the natural gas utilities. For example, natural gas  
4 distribution utilities have the advantage of reconciled recovery mechanism for the cost  
5 of natural gas delivered by the utility, natural gas has a fairly well developed  
6 competitive market, and, for many natural gas utilities operating outside Pennsylvania,  
7 they have a weather normalization feature in their tariffs. These features are missing  
8 from electric delivery utilities in Pennsylvania and make electric delivery utilities more  
9 risky.

10 **Q. With these advantages for the natural gas utilities, can you explain why the DCF**  
11 **calculations for Gas Group indicate a higher cost of equity than for the Electric**  
12 **Group that you considered?**

13 A. The question is not why the DCF results for the Gas Group are higher than the Electric  
14 Group, but rather why the DCF results for the Electric Group are lower. In my  
15 opinion, the results of the DCF for the Gas Group are far more reliable than those of  
16 the Electric Group. As I explained in my direct testimony, the DCF results for the  
17 Electric Group are suspect due to all of the uncertainties surrounding the structure and  
18 future regulation of electric delivery utilities. Keep in mind that electric delivery  
19 utilities are relatively new compared to gas delivery utilities. As such, the newness of  
20 the electric delivery business and uncertain regulatory treatment means that the growth  
21 rates for the Electric Group are more tenuous than for the Gas Group.

22 **Q. Please comment on the growth prospects for the Gas Group in light of Mr.**  
23 **Kahal's observations along these lines.**

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 A. As a response to Mr. Kahal's observation, the DCF growth rate that I used for the Gas  
2 Group was within the array of analysts' growth forecasts, and not a simple average as  
3 computed by Mr. Kahal. Even if I used the simple average of the growth rates that Mr.  
4 Kahal computed (which I did not), the DCF cost rate for the Gas Group would provide  
5 a return of 10.71% (4.18% + 5.74% + 0.79%) including the necessary adjustment  
6 when defining this cost rate in terms of the book value capital structure.

7 **Q. Value Line has described its view of the investment fundamentals for the electric  
8 utility business. Please describe this statement.**

9 A. As revealed in the June 4, 2004 issue of Value Line:

10 Eastern electric utility stocks, as a group, currently reside  
11 at the bottom of the *Value Line* ranking system. These issues  
12 have suffered in recent months, given rising inflationary  
13 pressures and the increasing likelihood that the Federal Reserve  
14 will soon begin to ramp up borrowing rates. Expanding fuel and  
15 purchase power costs, outlays to ensure reliability, and employee  
16 benefit expenses are pressuring net margins at many distribution  
17 companies, particularly those still operating under electricity  
18 price caps. A number of nonregulated merchant subsidiaries  
19 continue to deal with capacity rich markets.  
20

21 We advise utility investors to stick to equities offering a  
22 yield and dividend growth at, or above, the industry averages.  
23 Too, investors should focus on companies that have low-cost  
24 generation, access to competitive markets, and stable finances.  
25

26 These fundamentals bear directly on the rate of return on common equity for PPLEU.

27 **Q. Mr. Kahal makes a variety of contentions that coverage and cash flow under his  
28 9.5% recommendation will meet certain credit quality benchmarks. Please  
29 comment.**

30 A. There are a variety of problems with Mr. Kahal's analysis. First, he assumes 9.5% will  
31 be earned by the Company, and this is an unlikely scenario given the significant capital

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 expenditures for the future and rising interest rates. The rejection of the Company's  
2 DSIC proposal by the opposing parties also would hinder its ability to achieve the  
3 allowed return. Second, Mr. Kahal's analysis does not reflect the updated PPLEU  
4 business position of "4" under the S&P release on June 2, 2004.

5 Even assuming that the Company could actually achieve the rate of return  
6 proposed by the OCA, the credit quality matrix is revealed below and is supported by  
7 details provided in Exhibit PRM-3 that was prepared by the Company. The  
8 benchmarks that the Company employs in gauging its credit quality measures are  
9 provided on Exhibit PRM-4. The benchmarks shown on Exhibit PRM-4 were taken  
10 from the matrices published by S&P, with modification to signify notches within a  
11 rating for plus (+) and minus (-). Also, the June 2, 2004 matrices published by S&P  
12 cover the categories of Funds from operations/Total debt, Funds from operations  
13 interest coverage, and Total debt/Total capital. The remaining two categories were  
14 taken from benchmarks criteria that were formerly published by S&P.

### S&P Ratings Criteria Applied to Projections with OCA's Proposal

<u>PPL Electric</u>	<u>Business Profile "4"</u>			
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Funds from operations / Total debt %	BBB	BBB	BBB	BBB
Funds from operations interest coverage (x)	A	A	A-	A-
Pretax interest coverage (X)	A	A	A-	BBB+
Total debt / Total capital (%)	A	A	A	A
Net cash flow / Capital expenditures (%)	BBB	BBB	BBB	BBB

15  
16 From the tabulation shown above, the OCA's proposal is only marginally supportive  
17 of the Company's current A- bond rating and will not provide the Company with any

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 cushion to deal with any adverse contingencies that may preclude the Company from  
2 actually achieving these benchmarks. Remember, the Company currently has a  
3 negative outlook from S&P for its bond rating. Moreover, the OCA's proposal  
4 provides the Company with an inadequate opportunity to achieve the higher A credit  
5 quality rating.

6 **Q. Turning next to Mr. Kahal's proxy group, does it provide an improvement on**  
7 **your Electric Group?**

8 A. No. Mr. Kahal proposes to eliminate two companies from my Electric Group and add  
9 another company. Removing the two electric companies operating in Vermont and  
10 adding another electric company operating in Connecticut, provides no improvement  
11 in the composition of the proxy group. The deletions and addition of companies to my  
12 group does not comply with the objectively determined selection criteria set forth in  
13 my direct testimony. Mr. Kahal acknowledges that Connecticut company has an  
14 unusually low growth rate. Moreover, the Connecticut electric utility that Mr. Kahal  
15 proposes to include does not have earnings that are adequate cover its actual dividend  
16 and is not projected to do so for 2004, 2005 and for the period 2007-09 according to  
17 Value Line. Due to inadequate earnings, Value Line is advising investors to avoid this  
18 stock, in spite of its high yield. He also seems to acknowledge that the two Vermont  
19 companies tend to increase the growth rate. As such, there is no need to alter my  
20 Electric Group unless the objective is to lower the growth rate.

21 **Q. In his direct testimony, Mr. Kahal provides retention growth estimates as one**  
22 **measure of the DCF growth rate. Will you comment?**

**REBUTTAL TESTIMONY OF PAUL R. MOUL**

1 A. This special form of the DCF merely adjusts the assumed return on book common  
2 equity by the difference between the dividend yield on book value and the dividend  
3 yield on market value. Retention growth along with external financing growth is  
4 another means of describing book value per share growth. A key component of  
5 retention growth is the assumed return on book common equity. Specifically, Mr.  
6 Kahal's proxy group is forecast to earn a 10.4% return on book equity according to  
7 Value Line. This is further evidence that investors expect an equity allowance in the  
8 10% to 12% range, since investors expect these companies to actually earn 10.4%.  
9 Mr. Kahal does not explain how his proxy group will earn a 10.4% return on equity, if  
10 the cost of equity is set by the commissions that regulate these companies at just  
11 9.50%.

12 **Q. With regard to the growth component of the DCF formula, do you believe that a**  
13 **3.5% to 4.5% growth rate recommended by Mr. Kahal is reasonable for his**  
14 **proxy group?**

15 A. The industry specific and macroeconomic factors discussed in my direct testimony  
16 show that growth rates for electric utilities are cyclically depressed at this time.  
17 Moreover, the additional Value Line growth measures shown on page 4 of Schedule  
18 MIK-4 are not the actual values published by Value Line. Investors would likely  
19 consider first the growth rates actually published by Value Line, rather than engaging  
20 in independent calculations of growth. To be consistent with the reporting of Value  
21 Line earnings per share growth shown on page 3 of Schedule MIK-4, the actual values  
22 would be as follows:

**REBUTTAL TESTIMONY OF PAUL R. MOUL**

	<u>Company</u>	<u>Additional Value Line Growth Measures</u>		<u>Retained Earnings</u>
		<u>2007-2009</u>		
		<u>Dividends</u>	<u>Book Value</u>	
1				
2				
3				
4				
5	C.H. Energy		1.0%	2.0%
6	Consolidated Edison	1.0%	2.5%	1.5%
7	Duquesne Light	-4.0%	5.0%	5.5%
8	Energy East	4.0%	3.0%	2.5%
9	Northeast Utilities	8.5%	4.5%	6.0%
10	NSTAR	2.5%	4.0%	4.5%
11	PEPCO	16.0%	1.5%	5.0%
12	UIL		-1.0%	
13	Central Vermont	3.5%	4.0%	4.5%
14	Green Mountain	<u>12.5%</u>	<u>3.5%</u>	<u>5.0%</u>
15	Average	5.5%	2.8%	4.1%

16 **Q. If forecast dividend share growth were incorporated into Mr. Kahal's DCF cost**  
 17 **rate, what would be the result?**

18 A. As supported by the reasoning advocated by DOD witness Mr. Kincel, the DCF cost  
 19 rate would become:

$$\begin{aligned}
 20 \quad & D/P (1 + .5g) + g = k \\
 21 \quad & 4.66\% (1.0275) + 5.5\% = 10.29\%
 \end{aligned}$$

22 This DCF result is without the leverage adjustment that the Commission has recently  
 23 utilized in its rate of return determinations. If that adjustment were included the DCF  
 24 cost rate would be increased to 10.73% (10.29% + 0.44%).

25 **Q. Mr. Kahal criticized the leverage adjustment that you propose to account for the**  
 26 **divergence of market capitalization and book value capitalization. Please**  
 27 **comment.**

28 A. It must be recognized that, in order to make the DCF results relevant in the ratesetting  
 29 context, the market-derived cost rate cannot be used without modification. The  
 30 importance of the leverage modification to the DCF results was fully supported in my

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 direct testimony, wherein it was shown that the market value of the equity in the  
2 Electric Group's and Gas Group's capitalization was much higher than its book value.  
3 To make the market-derived DCF results applicable in the ratesetting context, it is  
4 necessary to account for the higher financial risk that arises from the lower common  
5 equity ratio measured by book value capitalization as compared to the higher common  
6 equity ratio measured by market capitalization. Because book value capital structures  
7 are used instead, my adjustment procedure is required.

8 **Q. Mr. Kahal claims that regardless of whether your leverage adjustment is**  
9 **necessary, it has been incorrectly calculated. Please respond.**

10 A. My adjustment is accurately calculated. It employs the FAS 107 data that each  
11 company must report in the financial statements filed with the SEC. Generally, these  
12 data exclude short-term debt, and Mr. Kahal offers absolutely no proof the market  
13 versus book value differences is "perhaps to 2 percentage points." Even if short-term  
14 debt were to be included in the calculation, it would affect both the market  
15 capitalization and the book value capitalization. Hence, Mr. Kahal has not proven his  
16 point. Recall, the adjustment must be made with the same set of companies, i.e., the  
17 market capitalization for Electric Group. Although the book value of PPLEU's capital  
18 structure ratios are between the market capitalization and book value capitalization of  
19 the Electric Group, the Company's relatively high business risk for an electric delivery  
20 utility (as shown by its "4" business profile) mandates a relatively stronger equity ratio  
21 to offset its higher business risk.

22 **Q. Mr. Kahal also argues that the adjustment is counterintuitive because the higher**  
23 **the stock price then the higher is the adjustment. Please respond.**

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 A. As a preliminary matter, the application of my leverage adjustment does not encourage  
2 higher market prices because the adjustment is calculated based on a specific market  
3 price. The adjustment is necessary because the DCF produces the investor required  
4 return on the current market price not the return on the book value capitalization. The  
5 leverage adjustment adds stability to the DCF cost rate. If the market capitalization  
6 increases relative to its book value, the leverage adjustment increases while the simple  
7 yield (D/P) plus growth (g) result declines. There is nothing counterintuitive about the  
8 adjustment. The reverse is also true, i.e., when the market capitalization declines, the  
9 leverage adjustment also declines as the simple yield (D/P) plus growth (g) result  
10 increases. That is to say, the DCF cost rate shown by the simple yield plus growth  
11 declines when market price goes up, but higher market prices can be attributed to a  
12 variety of factors that relate to market sentiment, which is unassociated with a  
13 company's underlying fundamentals. As explained elsewhere, this indicates that  
14 models other than just DCF should be used to measure the cost of equity.

15 **Q. Mr. Kahal has used a market premium that is derived from a total market return**  
16 **of 11% to 12%. Will you comment?**

17 A. It is important when using the CAPM that the total market return (combination of the  
18 risk free rate of return and the market risk premium) reflect reasonable expectations for  
19 the future. The total market return for 2003 was 28.70% for the S&P Composite  
20 Index. While the year-to-date returns for the S&P Composite Index have been just  
21 7.00% on an annualized basis for 2004, a simple DCF return for the S&P Composite  
22 Index would provide a 12.55% (1.70% (1.0538) + 10.76%) return based upon the  
23 earnings forecast contained in the data provided by Mr. Kahal. Moreover, the July 23,

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1        2004 Value Line forecast provides a 12.37% total market return.<sup>2</sup> This shows that an  
2        11% to 12% total market return is too low for use in the CAPM and the range should  
3        be 12% and higher. Therefore, Mr. Kahal has understated the cost of equity in his  
4        CAPM analysis.

5        **Q. Do you agree with the betas that Mr. Kahal used in his CAPM calculation?**

6        A. Only in part. While I agree that the Value Line betas can be used as a starting point,  
7        they must be unlevered and relevered for the same reasons indicated above regarding  
8        the leverage difference between the market and book value capitalization.

9        **Q. Does the trend toward higher interest rates help explain the understatement of**  
10       **the CAPM cost rate proposed by Mr. Kahal?**

11       A. Yes. By using a current interest rate of 5.0% to 5.5% as compared to a prospective  
12       interest rate of 6.0% during the rate effective period, Mr. Kahal has understated the  
13       CAPM cost rate. Mr. Kahal claims that he prefers to rely on current known interest  
14       rates. However, it is critical to reflect investors' expectations of higher interest rates in  
15       the future under current circumstances. Mr. Kahal compounded this omission by also  
16       rejecting the size adjustment through his focus on the parent company, PPL  
17       Corporation. We are setting the cost of common equity allowance for PPLEU not PPL  
18       Corporation. PPLEU is clearly smaller than companies used in the CAPM market  
19       return and as recognized by Mr. Kahal would be no better than a mid cap company on  
20       a stand alone basis. Relying on the size of PPL Corporation to reject the CAPM size  
21       adjustment, when considered in conjunction with Mr. Kahal's refusal to reflect higher

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<sup>2</sup> The estimated median appreciation potential is forecast to be 50% for 3 to 5 years hence. The annual capital gains yield at the midpoint of the forecast period is 10.67% (i.e.,  $1.50^{.25} - 1$ ). With a median dividend yield of

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 prospective interest rates, indicates that Mr. Kahal is attempting to adjust his CAPM  
2 analysis downward to support his inadequate DCF result. To recalculate, Mr. Kahal's  
3 CAPM with forecast interest rates and the size adjustment, the return would be:

$$4 \quad RF + \beta (Rm-Rf) + size = k$$
$$5 \quad 6.0\% + .69 (12.25\% - 6\%) + 0.82\% = 11.13\%$$

6 Again, I note that the betas should be adjusted for the book value capitalization rather  
7 than the market value capital that is used above. If the betas are adjusted the CAPM  
8 result is as follows:

$$9 \quad RF + \beta (Rm-Rf) + size = k$$
$$10 \quad 6.0\% + .73 (12.25\% - 6\%) + 0.82\% = 11.38\%$$

11 **Q. Please comment further on Mr. Kahal's observation that the size of PPL**  
12 **Corporation negates the need for a size adjustment to the CAPM.**

13 A. Mr. Kahal's attempt to disregard the size adjustment further demonstrates that he  
14 refuses to recognize the risks of PPLEU. Indeed, my size adjustment to the CAPM is  
15 not related to PPL Corporation because it is based on the market capitalization of the  
16 Electric Group and the Gas Group. Mr. Kahal's reference to PPL Corporation merely  
17 shows that he is attempting to ignore the Company's risk characteristics, as displayed  
18 by the proxy groups.

19 **Q. Please respond to Mr. Kahal's testimony concerning your Risk Premium**  
20 **approach that utilizes historical returns as one method to determine the**  
21 **prospective risk premium.**

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1.7%, the total market return is 12.37% (1.7% + 10.67%).

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 A. Mr. Kahal indicates that there is no evidence that after-the-fact historical returns are  
2 employed today by investors. Mr. Kahal, however, offers no evidence that investors  
3 are not influenced by historical returns. Indeed, the widespread use of these data in the  
4 financial community indicates that these data do have an influence on investors. The  
5 Ibbotson data that reports historical returns has been cited on 312 occasions in The  
6 Wall Street Journal and Barron's since 1996. Importantly, the use of historical data  
7 provides an objective basis to observe trends and relationships between variables. Past  
8 performance, after all, provides the only data that can be statistically analyzed with any  
9 degree of precision. I seriously doubt that investors would not apprise themselves of  
10 historical performance prior to undertaking an investment.

11 **Q. Mr. Kahal raises the issue of market returns versus book returns in his critique of**  
12 **your Comparable Earnings approach. Please comment.**

13 A. The introduction of the market versus book returns, as part of his critique of my  
14 Comparable Earnings method, provides belated recognition of the factors I discussed  
15 above regarding the DCF and CAPM.

16 Mr. Kahal argues that investors' ultimate interest is a company's market return-  
17 - the return rate achieved on the market price paid. Mr. Kahal seems to imply that  
18 returns less than those shown by the Comparable Earnings method will be realized by  
19 investors because they are returns on book value and not market prices. However, this  
20 admission goes to the core of the infirmity of unadjusted DCF and CAPM results when  
21 applied to book value. Since these analyses produced return rates on market  
22 capitalization, they must be adjusted to determine the investor expected return rate on  
23 book value.

REBUTTAL TESTIMONY OF PAUL R. MOUL

IV. Response to OTS witness Deardorff

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**Q. What is your overall assessment of the cost of equity proposed by OTS witness Mr. Deardorff?**

A. In my experience, an 8.75% rate of return on common equity proposal is unprecedented in a rate case before this Commission for an electric utility. It is wholly inadequate especially during a period of rising interest rates.

In 2003, Mr. Deardorff submitted rate of return testimony where he advocated an equity return in the range of 9.25% to 10.00% for PAWC, when the forecast yields on Aaa-rated corporate bonds were 5.5% to 6.4% over the near-term. In 2004, he advocated a 9.50% to 10.00% rate of return on common equity for API when forecast the yields on Aaa-rated corporate bonds were 5.7% to 6.6% over the near-term. In this case, Mr. Deardorff proposes an 8.75% to 9.00% rate of return on common equity when the forecast yields on Aaa-rated corporate bonds are 6.0% to 6.9% over the near-term. The relative changes in his position were:

	<u>ROE Proposal</u>	<u>Change</u>	<u>Aaa-Corporate Bond yield</u>	<u>Change</u>
PAWC	10.00%		5.5%	
API	9.50%	- 0.50%	5.7%	+0.2%
PPLEU	8.75%	- 0.75%	6.0%	+0.3%

It just makes no sense that when interest rates are rising Mr. Deardorff is proposing a lower rate of return on common equity. Essentially, he has reduced his risk premium from 4.5% (10.00% - 5.5%) in the PAWC case, to 3.8% (9.50% - 5.7%) in the API case, to 2.75% (8.75% - 6.0%) in the PPLEU case. There is no justification for these

**REBUTTAL TESTIMONY OF PAUL R. MOUL**

1 actions. It is also useful to compare the relative business profiles and credit quality for  
2 PPLEU to PAWC and API. Those comparisons are:

	<u>S&amp;P Business Profile</u>	<u>S&amp;P CCR</u>
3 PAWC <sup>3</sup>	2	A
4 API	2	A+
5 PPLEU	4	A-

6  
7  
8  
9 **Q. Mr. Deardorff has selected the low point in his range of returns in the case for  
10 PPLEU. Is this reasonable?**

11 A. No. Mr. Deardorff claims to select the low point in his range for PPLEU to reflect  
12 differences in financial risk. He also selected the low point in his range in the case of  
13 API and he selected the top of his range in PAWC, in each instance due to financial  
14 risk differences.

15 His selection of the low point in his range for PPLEU is in marked contrast to  
16 the other cost of equity experts in this case. Indeed, Mr. Kahal recommended the  
17 upper end of his 8.5% to 9.5% range for PPLEU. Mr. Kincel recommended a 10.75%  
18 equity return, which is in the top half of his range of 10.25% to 11.00%. In contrast to  
19 Mr. Deardorff's position, Mr. Kahal and Mr. Kincel have recognized additional factors  
20 which strongly support an equity return for PPLEU which is substantially above the  
21 low point of the range advocated by Mr. Deardorff.

22 **Q. What credit quality profile would be provided, as an opportunity, with OTS'  
23 proposed rate relief?**

24 A. Again, the proposals by the parties in this case provide merely an opportunity to

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<sup>3</sup> The business profile and credit rating is for American Water Capital Corp. the financing vehicle used by

**REBUTTAL TESTIMONY OF PAUL R. MOUL**

1 experience a particular level of return and credit quality. In addition, with the  
 2 opposition to the DSIC by the OTS, such opportunity will be even more difficult to  
 3 achieve. Based upon the entire matrix of leverage, pre-tax coverage, and cash flow  
 4 benchmarks and the Company's recalibrated "4" business profile, it is incorrect to  
 5 conclude that Mr. Deardorff's recommendation will maintain the Company's A- bond  
 6 rating. The following table provides a summary of this assessment based upon the  
 7 forecasts provided in Exhibit PRM-5, which were prepared by the Company.

S&P Ratings Criteria Applied to Projections

<u>PPL Electric</u>	<u>Business Profile "4"</u>				
	2004	2005	2006	2007	2008
Funds from operations / Total debt %	BBB-	BBB	BBB	BBB	BBB
Funds from operations interest coverage (x)	BBB	A-	A-	BBB+	BBB+
Pretax interest coverage (X)	BB	BBB+	BBB+	BBB	BBB
Total debt / Total capital (%)	A	A	A	A	A
Net cash flow / Capital expenditures (%)	A-	BBB	BBB	BBB	BBB

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 19 Clearly, Mr. Deardorff's proposed cost of equity for PPLEU will encourage a  
 20 downgrade of the Company's bond rating. Further, I note that Mr. Deardorff's  
 21 proposal would provide an inadequate profile at the current business position of "4."  
 22 If the Commission were to drastically reduce the return allowance as proposed by Mr.  
 23 Deardorff, PPLEU's business profile could worsen subjecting it to even higher  
 24 standards to achieve a particular bond rating.

25 **Q. Would the use of cost of equity methods other than DCF, as applied to the electric**  
 26 **barometer group reveal that Mr. Deardorff's proposed rate of return on common**  
 27 **equity is much too low?**

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 A. His recommendation is too low due to sole reliance on DCF, which the Commission  
2 recognizes understates cost of common equity, without adjustment. If Mr. Deardorff  
3 had employed other methods/models of the cost of equity and/or used proxy groups of  
4 non-electric companies, he would have discovered that his recommendation is too low.

5 **Q. Mr. Deardorff challenges the ex-dividend adjustment in the calculation of your  
6 dividend yields. Please respond.**

7 A. Mr. Deardorff challenges my consideration of the timing of the dividend payments  
8 relative to the ex-dividend date. He claims there is no academic support for the  
9 adjustment and that there are no financial publications that provide ex-dividend  
10 adjusted yields.

11 As to Mr. Deardorff's first point, there has been extensive academic research  
12 on the impact of the ex-dividend on stock prices. I am aware of at least five academic  
13 studies that indicate that stock prices react to the ex-dividend factor<sup>4</sup>. As to Mr.

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<sup>4</sup> Avner Kalay, "The Ex-Dividend Day Behavior of Stock Prices: A Re-examination of the Clientele Effect," *Journal of Finance*, 37 (September 1982), 1059-70; Keneth M. Eades, Patrick J. Hess, and E. Han Kim, "On Interpreting Security Returns During the Ex-Dividend Period," *Journal of Financial Economics*, 13 (March 1984), 3-34; Patrick J. Hess, "The Ex-Dividend Day Behavior of Stock Returns: Further Evidence on Tax Effects," *Journal of Finance*, 37 (May 1982), 445-56; James M. Poterba and Lawrence H. Summers, "New Evidence That Taxes Affect the Valuation of Dividends," *Journal of Finance*, 39 (December 1984), 1397-1416; Michael Barclay, "Tax Effects with No Taxes? Further Evidence on the Ex-Dividend Day Behavior of Common Stock Prices," working paper, Stanford University (September 1984); and Costas P. Kaplanis, "Options, Taxes, and Ex-Dividend Day Behavior," *Journal of Finance*, 41 (June 1986), 411-24.

See Kalay, "The Ex-Dividend Day Behavior of Stock Prices"; Jerry Green, "Taxation and the Ex-Dividend Day Behavior of Common Stock Prices" working paper. National Bureau of Economic Research, Cambridge, Mass (1980); and Hess, "The Ex-Dividend Day Behavior of Stock Returns." Black and Scholes, "The Effects of Dividend Yield and Dividend Policy on Common Stock Prices and Returns."

Miller and Scholes, "Dividends and Taxes." See Marshall Blume, "Stock Returns and Dividend Yields: Some More Evidence." *Review of Economics and Statistics*, 62 (November 1980), 567-77.

Edwin J. Elton and Martin J. Gruber, "Marginal Stockholder Tax Rates and the Clientele Effect," *Review of Economics and Statistics*, 52 (February 1970), 68-74.

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 Deardorff's second point, the ex-dividend dates are routinely reported in the financial  
2 press, and they are widely available on the internet. Moreover, the Barron's source  
3 that Mr. Deardorff has used for his stock prices, as well as The Wall Street Journal,  
4 identifies when stocks trade ex-dividend (i.e. the purchaser of the stock will not be  
5 entitled to receive the next dividend). In addition, the SEC explained:

6 "With a significant dividend, the price of a stock may move up by  
7 the dollar amount of the dividend as the ex-dividend date  
8 approaches and then fall by that amount after the ex-dividend date.  
9 A stock that has gone ex-dividend is marked with an "x" in  
10 newspapers on that day."

11  
12 The Wall Street Journal signifies the lack of a pricing change attributed to the ex-  
13 dividend by the "x" notation in its stock listings although the actual price declines by  
14 the amount of the dividend on that day. Mr. Kincel has also correctly employed the  
15 ex-dividend into his computation of the dividend yield.

16 **Q. Please respond to Mr. Deardorff's growth rate analysis?**

17 A. The data that he used to develop his growth rate contains an error<sup>5</sup> and is based on  
18 Value Line reports that are out-of-date. Using the June 4, 2004 Value Line reports, the  
19 Value Line growth rates are:

20

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<sup>5</sup>Mr. Deardorff misplaced the decimal for the Value Line dividend growth for PEPCO, resulting in a corrected average of 6.83% for the Nine Company Average and 7.83% for the Six Company Average.

**REBUTTAL TESTIMONY OF PAUL R. MOUL**

Value Line Expected Growth Rates  
for the Barometer Group of Electric Companies

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<u>Company</u>	<u>Dividend Growth</u>	<u>Earnings Growth</u>
CH Energy Group		0.5%
Central Vermont PS	3.5%	7.5%
Consolidated Edison	1.0%	-1.5%
Duquesne Light Holdings	-4.0%	11.0%
Energy East Corp.	4.0%	1.0%
Green Mountain Power	12.5%	3.5%
Northeast Utilities	8.5%	10.0%
NSTAR	2.5%	3.0%
Pepco Holdings	16.0%	3.5%
<b>Nine Company Average</b>	<b>4.9%</b>	<b>4.3%</b>
<b>Six Company Average</b>	<b>4.7%</b>	<b>4.5%</b>
<b>PPL Corporation</b>	<b>7.0%</b>	<b>5.5%</b>

15 **Q. Will you provide the resulting DCF return using the Value Line dividend growth**  
16 **rates?**

17 **A. With the Value Line dividend growth rates shown above, Mr. Deardorff's DCF return**  
18 **would be as follows:**

	<u>Average Dividend Yield</u>	+	<u>Growth Rate</u>	=	<u>Return</u>
Six Company Group	5.02%		4.70%		9.72%
Nine Company Group	4.83%		4.90%		9.73%
PPL Corporation	4.05%		7.00%		11.05%

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 These DCF results are calculated without the necessary adjustment that relate the  
2 returns to the book value capitalization and would be increased by 0.44% for that  
3 adjustment related to the six and nine company groups, i.e., 10.16% (9.72% + 0.44%)  
4 and 10.17% (9.73% + 0.44%), respectively.

5 **Q. Please respond to Mr. Deardorff's criticism of your leverage adjustment.**

6 A. Mr. Deardorff's critique of my adjustment mischaracterizes it as an adjustment for  
7 market/book ("MB") ratios. This adjustment contains no factor that would express the  
8 DCF return for any particular market-to-book ratio. Perhaps, it is worthwhile to recap  
9 the procedure used in making my adjustment. This is a three step process, the first and  
10 third steps having multiple parts. In step one, the DCF cost of equity is calculated  
11 using the market price of stock and the capital structure ratios are computed from the  
12 market capitalization of both the debt and equity of a firm. In step two, a completely  
13 unlevered cost of equity is calculated, as if the firm were 100% equity financed. In the  
14 third step, a relevered cost of equity is calculated with the capital structure determined  
15 from the book value capitalization. There is absolutely no reference to MB ratios in  
16 the process of adjusting the DCF return for application to the book value capitalization.

17 In further response to Mr. Deardorff's specific points, first it is a misperception  
18 that market prices in excess of book value are symptomatic of earnings that exceed a  
19 firm's cost of capital. Mr. Deardorff fails to realize that stock prices above book value  
20 are common for utility stocks, and indeed for all of the major market indexes.  
21 According to the Barron's issue of May 24, 2004 (the one relied upon by Mr.  
22 Deardorff), utility stocks were trading at a multiple of 1.87 times book value, the S&P  
23 500 index was trading at 3.37 times book value, the S&P Industrial index was at 3.99

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 times book value, and the Dow Jones Industrial index was trading at 4.36 times book  
2 value. It is difficult to accept that the vast majority of all firms with publicly traded  
3 stocks are generating returns far in excess of their cost of capital. Certainly, in our  
4 free-market economy, competition should constrain such "excesses" if they indeed  
5 existed.

6 **Q. But does not your leverage adjustment encourage higher MB ratios?**

7 A. No. Mr. Deardorff also claims that my leverage adjustment will encourage even  
8 higher MB ratios. The magnitude of the leverage adjustment is affected by all of the  
9 factors listed above. During a period of rising MB ratios, the sum of the simple yield  
10 (D/P) plus growth (g) will decline. That is to say, the DCF cost rate shown by the  
11 simple yield plus growth declines when the market price goes up but a higher market  
12 price could be attributed to a variety of factors that relate to market sentiment, which is  
13 unassociated with a company's underlying fundamentals.

14 In this regard, it is important to recognize that the leverage adjustment is  
15 affected by changes in various factors, including changes in market capitalization and  
16 book capitalization, the components of yield and growth, and the overall level of  
17 capital costs as revealed by the cost of debt and preferred stock.

18 **Q. What about Mr. Deardorff's assertion that your adjustment is not consistent with**  
19 **standard finance theory?**

20 A. That claim is baseless. My adjustment is entirely consistent with financial theory.  
21 Among other factors, the adjustment takes into consideration the proportions of debt  
22 and equity in the market capitalization of a firm. The calculations that I performed to  
23 identify the adjustments are not performed with different firms with varying risk

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 levels, as would be inferred from Mr. Deardorff's quote from my direct testimony.  
2 Rather, I utilized the same set of companies to calculate the adjustment starting first  
3 with the market value of debt and equity and ending with the book value of debt and  
4 equity for the same companies. Again, Mr. Deardorff's observations are misplaced  
5 because he perceives the adjustment to be a function of MB ratios, when it is not.

6 **Q. Mr. Deardorff also references your testimony in a 20-year old case involving Blue**  
7 **Mountain Consolidated Water Company. Is there any merit to this criticism?**

8 A. No. In its decision on remand, the Commission noted that over a period of years it is  
9 relatively easy to discern the trends in market-to-book ratios which, when compared to  
10 performance in other financial ratios, can give an indication of the proper return the  
11 Commission must award to assure reasonable access by public utilities to the major  
12 capital markets. The trends in market-to-book ratios during that period were  
13 substantially different from today. At the time that case was litigated, market-to-book  
14 ratios for the broad market generally fluctuated around a relatively narrow band where  
15 market prices were approximately equal to book value. That is to say, the Dow Jones  
16 Industrial Average market to book ratios for quite a number of years in the late 1970s  
17 were about equal to book value. And, there was no large change during that period in  
18 those market-to-book ratios for the broad market.

19 **Q. How have stock prices performed over the last 20 years?**

20 A. Prices have moved markedly higher than book value. So, while the market-to-book  
21 ratio of the DJI was around book value in the late 1970s, today the DJI is 436% of  
22 book value. The capital markets today are markedly different than those that existed at  
23 the time of the Blue Mountain case. I should also note that, the Commission has never

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 attempted to control market prices, nor could it. Moreover, the Blue Mountain case  
2 relied heavily on earnings/prices ratios to set the return on equity. There are virtually  
3 no similarities between Blue Mountain and this case.

4 **Q. Please respond to Mr. Deardorff's comments regarding your Risk Premium and**  
5 **CAPM approach.**

6 A. Mr. Deardorff makes the unfounded assertion that, although the Risk Premium and  
7 CAPM methods are relevant to investment decision making, they may be ignored in  
8 the public utility ratesetting process. In fact, it is precisely because investors consider  
9 the results of other methods that they too should be used in addition to the DCF in the  
10 development of the cost of equity in this proceeding. Mr. Deardorff's assertion that  
11 the Risk Premium method does not measure the current cost of equity as directly as the  
12 DCF is similarly without foundation. First, the Risk Premium approach uses current  
13 and forecast interest rate data, which represents the major component of the cost of  
14 equity expressed in terms of this model. Second, I do not claim that there is a  
15 "constant" risk premium, nor do my calculations imply that there is one.

16 Historical data must be used cautiously because the analyst must be cognizant  
17 of fundamental changes that have occurred. Historical data, when used for analytical  
18 purposes, must be sufficiently broad to account for trends and cyclical variations. To  
19 the extent that the future is expected to diverge from the past, adjustments can be made  
20 to the results of the historical analysis to accommodate perceived changes in risks  
21 which may occur in the future. Any analyst, including myself, must formulate  
22 judgments about the future based upon knowledge gleaned from past performance.  
23 Past performance, after all, provides the only data that can be statistically analyzed

## REBUTTAL TESTIMONY OF PAUL R. MOUL

1 with any degree of precision. Judgments can then be made to accommodate  
2 expectations about the future that may diverge from the past. As explained in my  
3 direct, the use of expected market returns produces greater risk premiums than historic  
4 returns. An investor would consider both in determining an expected return. Finally,  
5 Mr. Deardorff's reference to the Fama/French model merely requires consideration of  
6 additional factors to explain stock returns. Fama/French identified the factors  
7 associated with the size of a firm and its book-to-market ratio as elements to be  
8 considered. Mr. Deardorff apparently chose to ignore these elements in his analysis.

### V. Summary

9  
10 **Q. Please summarize your Rebuttal Testimony.**

11 A. The central issue concerning the cost of equity in this case relates to whether the final  
12 determination will reflect capital market fundamentals that are likely to exist during  
13 the rate effective period and will provide returns expected by investors. With forecasts  
14 of higher interest rates, the cost of equity proposals by the OCA and OTS are far too  
15 low relative to investors' expectations, even in today's markets. It is clear that  
16 investors' expectations of allowed returns for electric delivery utilities are in the range  
17 of 10% to 12%. Of the proposals by all parties, only the Company's proposed 11.50%  
18 cost of equity and the DOD's proposed 10.75% cost of equity fall within this range. In  
19 order to adequately reflect the risk of an electric delivery utility in Pennsylvania,  
20 PPLEU's specific risks, and the Company's management efficiency, a return of  
21 11.50% is appropriate in this case.

22 **Q. Does this conclude your direct testimony?**

23 A. Yes.

S&P Corporate Credit Rating and Business Profile

Number of Companies	CCR						Profile					
	AA	A	BBB	BB	B	1	2	3	4	5	6	
Water	Beiton Rouge Water Works Co.	Aqua Pennsylvania Elizabethtown Water Co California Water Service Co. Connecticut Water Serv. Inc. Aquapon Water Co. of CT American Water Capital Corp. Middlesex Water Co. The York Water Co. Southern California Water Co. United Water New Jersey United Water works				Beiton Rouge Water Works Co.	Aqua Pennsylvania Elizabethtown Water Co. Connecticut Water Serv. Inc. Aquapon Water Co. of CT American Water Capital Corp. The York Water Co.	California Water Service Co. Middlesex Water Co. Southern California Water Co.	United Water New Jersey United Water works			
Gas	Norco Gas Co. Washington Gas Light Co.	New Jersey Natural Gas Co. KeySpan Energy Delivery NY Questar Gas Co. Southern California Gas Co. Northwest Natural Gas Co. NSTAR Gas Co. Piedmont Natural Gas Co., Inc. Laclede Gas Co. Boston Gas Co. Colonie Gas Co. Alabama Gas Corp. Atlanta Gas Light Co. Public Service Co. of NC, Inc. Wisconsin Gas Co. North Shore Gas Co. Peoples Gas Light & Coke Co. ONEOK Inc. Indiana Gas Co. Inc.	Cascade Natural Gas Corp. South Jersey Gas Co. Connecticut Natural Gas Corp. Southern Connecticut Gas Co. Yankee Gas Services Co. UGI Utilities Inc. Bay State Gas Co. Southwest Gas Corp. Southern Union Co. TXU Gas Co.	NUI Utilities Inc. SEMCO Energy Inc.		New Jersey Natural Gas Co. KeySpan Energy Delivery NY Southern California Gas Co. Northwest Natural Gas Co. Indiana Gas Co. Inc.	Norco Gas Co. Washington Gas Light Co. NSTAR Gas Co. Piedmont Natural Gas Co., Inc. Boston Gas Co. Colonie Gas Co. Alabama Gas Corp. Atlanta Gas Light Co. Public Service Co. of NC, Inc. Wisconsin Gas Co. North Shore Gas Co. Peoples Gas Light & Coke Co. Bay State Gas Co.	Duquesne Gas Co. Laclede Gas Co. Connecticut Natural Gas Corp. Southern Connecticut Gas Co. Yankee Gas Services Co. Southwest Gas Corp. Southern Union Co. TXU Gas Co.	UGI Utilities Inc. NUI Utilities Inc.	SEMCO Energy Inc.	ONEOK Inc.	
Electric		KeySpan Energy Delivery Long Island Boston Edison Co. Commonwealth Electric Co. Cambridge Electric Light Co. Massachusetts Electric Co. Narragansett Electric Co. Consolidated Edison Co. of NY Orange and Rockland Utilities Inc. Rockland Electric Co. PPL Electric Utilities Corp. Commonwealth Electric Co. Central Illinois Public Service Co.	Western Massachusetts Elec. Co. Central Maine Power Co. Atlantic City Electric Co. Potomac Electric Power Co. Delmarva Power & Light Co. Connecticut Light & Power Co. AEP Texas Central Co. AEP Texas North Co. Columbia Southern Power Co. Ohio Power Co. Centerpoint Energy Houston Elec. Duquesne Light Co. Jersey Central Power & Light Co. Metropolitan Edison Co. Pennsylvania Electric Co.	Texas-New Mexico Power Co.	Potomac Edison Co. West Penn Power Co.	KeySpan Energy Delivery Long Island Boston Edison Co. Commonwealth Electric Co. Cambridge Electric Light Co. Massachusetts Electric Co. Narragansett Electric Co. Western Massachusetts Elec. Co.	Consolidated Edison Co. of NY Orange and Rockland Utilities Inc. Rockland Electric Co. AEP Texas Central Co. AEP Texas North Co.	Central Illinois Public Service Co. Central Maine Power Co. Atlantic City Electric Co. Potomac Electric Power Co. Delmarva Power & Light Co. Connecticut Light & Power Co. Columbus Southern Power Co. Ohio Power Co. Centerpoint Energy Houston Elec. Potomac Edison Co. West Penn Power Co.	PPL Electric Utilities Corp. Commonwealth Edison Co. Duquesne Light Co. Jersey Central Power & Light Co. Metropolitan Edison Co. Pennsylvania Electric Co. Texas-New Mexico Power Co.			
Combination		Niagara Mohawk Power Corp. Central Hudson Gas & Elec. Co. PEPCO Energy Co.	Baltimore Gas & Electric Co. Public Service Electric & Gas Co.					Niagara Mohawk Power Corp. Central Hudson Gas & Elec. Co. Baltimore Gas & Electric Co. Public Service Electric & Gas Co.	PEPCO Energy Co.			

S&P Ratings Criteria Applied to Projections

**PPL Electric**

**Business Profile "4"**

	2005	2006	2007	2008
<b>Funds from operations / Total debt %</b>				
Funds from operations - unadjusted	515	545	555	569
<b>Adjustments</b>				
Less: ITC Amortization	(261)	(284)	(295)	(313)
Less: Working capital changes	-	-	-	-
Less: Capital lease amortization				
Funds from operations - Adjusted	254	261	260	256
<b>Total debt</b>				
LT debt (excluding Securitization)	1,376	1,431	1,431	1,442
ST debt including Intercompany	33	12	57	71
Leases	0	0	0	0
	1,409	1,442	1,488	1,513
	18.0%	18.1%	17.5%	16.9%
	BBB	BBB	BBB	BBB
<b>Funds from operations interest coverage (x)</b>				
Funds from operations (adjusted)	254	261	260	256
Interest	163	143	132	112
Securitization Interest - Pre-Tax	(75)	(56)	(35)	(13)
Lease - Interest included as rent	0	0	0	0
	342	349	357	355
<b>Interest</b>				
Interest	163	143	132	112
Securitization Interest - Pre-Tax	(75)	(56)	(35)	(13)
Lease - Interest included as rent	0	0	0	0
Total Interest (Excluding Securitization)	88	87	97	99
	3.89	3.99	3.69	3.60
	A	A	A-	A-
<b>Pretax interest coverage (X)</b>				
Income before income taxes	238	240	228	215
Interest	163	143	132	112
Securitization Interest - Pre-Tax	(75)	(56)	(35)	(13)
Lease - Interest included as rent	0	0	0	0
AFUDC equity	0	0	0	0
	326	327	324	313
<b>Total interest (incl. capital lease less secure)</b>				
	88	87	97	99
	3.72	3.74	3.36	3.18
	A	A	A-	BBB+
<b>Total debt / Total capital (%)</b>				
Total debt (incl cap leases)	1,409	1,442	1,488	1,513
TOPRs	0	0	0	0
Total debt (incl cap leases)	1,409	1,442	1,488	1,513
<b>Total capital</b>				
Total debt (Excluding Securitization Bonds)	1,409	1,442	1,488	1,513
Common equity	1,285	1,333	1,378	1,422
Minority interest	0	0	0	0
Preferred stock (Excluding TOPRs)	51	51	51	51
Total Capitalization	2,744	2,826	2,917	2,985
Adjustment to reduce MI / Pref to 10%	0	0	0	0
Total adjusted deb	1,409	1,442	1,488	1,513
	51.3%	51.0%	51.0%	50.7%
	A	A	A	A
<b>Net cash flow / Capital expenditures (%)</b>				
Net cash flows	254	261	260	256
Less: dividends	(91)	(92)	(87)	(82)
	163	169	173	174
<b>Capital expenditures</b>				
Capital expenditures	183	203	217	209
Global Investments	0	0	0	0
	183	203	217	209
	89%	84%	80%	83%
	BBB	BBB	BBB	BBB

**S&P Financial Medians - Electric Utilities**  
**Using 4 Ranking per June 02, 2004 S&P Utility Perspective**

FFO/Total debt %		FFO interest cov (x)		Debt/Total capital (%)		Pretax interest cov.		Net cash flow/ Capital expenditures (%)	
0.00%	B-	0.00	B-	<b>38.00%</b>	AA+	<i>0.00</i>	B-	0.00%	B-
2.67%	B	0.50	B	22.50%	AA	<i>0.43</i>	B	27.98%	B
6.22%	B+	1.17	B+	<b>45.00%</b>	AA-	<i>1.01</i>	B+	35.98%	B+
<b>8.00%</b>	BB-	<b>1.50</b>	BB-	32.33%	A+	<b>1.30</b>	BB-	35.99%	BB-
9.33%	BB	1.83	BB	49.67%	A	<i>1.60</i>	BB	45.59%	BB
11.11%	BB+	2.28	BB+	<b>52.00%</b>	A-	<i>2.00</i>	BB+	55.20%	BB+
<b>12.00%</b>	BBB-	<b>2.50</b>	BBB-	53.78%	BBB+	<b>2.20</b>	BBB-	<b>60.00%</b>	BBB-
14.67%	BBB	2.83	BBB	58.67%	BBB	<i>2.57</i>	BBB	75.00%	BBB
18.22%	BBB+	3.28	BBB+	<b>62.00%</b>	BBB-	<i>3.06</i>	BBB+	90.00%	BBB+
<b>20.00%</b>	A-	<b>3.50</b>	A-	61.78%	BB+	<b>3.30</b>	A-	<b>100.00%</b>	A-
22.67%	A	3.73	A	66.00%	BB	<i>3.53</i>	A	110.00%	A
26.22%	A+	4.04	A+	<b>68.00%</b>	BB-	<i>3.84</i>	A+	119.99%	A+
<b>28.00%</b>	AA-	<b>4.20</b>	AA-	68.17%	B+	<b>4.00</b>	AA-	<b>120.00%</b>	AA-
31.50%	AA	4.60	AA	71.00%	B	<i>4.30</i>	AA	125.00%	AA
<b>35.00%</b>	AA+	<b>5.00</b>	AA+	72.50%	B-	<b>4.60</b>	AA+	<b>130.00%</b>	AA+

Key to matrix values:

**Bold = S&P published benchmarks**

Non-formatted = calculated values to provide notches for plus (+) and minus (-) designations

*Italics = benchmarks previously published by S&P*

S&P Ratings Criteria Applied to Projections

**PPL Electric**

**Business Profile "4"**

	2004	2005	2006	2007	2008
<b>Funds from operations / Total debt %</b>					
Funds from operations - unadjusted	460	489	519	529	543
<b>Adjustments</b>					
Less ITC Amortization	(259)	(261)	(284)	(295)	(313)
Less: Working capital changes	-	-	-	-	-
Less Capital lease amortization	-	-	-	-	-
Funds from operations - Adjusted	201	228	235	234	230
<b>Total debt</b>					
LT debt (excluding Securitization)	1,385	1,376	1,431	1,431	1,442
ST debt including Intercompany	2	42	30	84	108
Leases	0	0	0	0	0
	1,387	1,418	1,460	1,515	1,549
	14.5%	16.1%	16.1%	15.4%	14.8%
	<b>BBB-</b>	<b>BBB</b>	<b>BBB</b>	<b>BBB</b>	<b>BBB</b>
<b>Funds from operations interest coverage (x)</b>					
Funds from operations (adjusted)	201	228	235	234	230
Interest	183	163	144	133	114
Securitization Interest - Pre-Tax	(93)	(75)	(56)	(35)	(13)
Lease - Interest included as rent	0	0	0	0	0
	291	316	324	332	330
Interest					
Interest	183	163	144	133	114
Securitization Interest - Pre-Tax	(93)	(75)	(56)	(35)	(13)
Lease - Interest included as rent	0	0	0	0	0
Total Interest (Excluding Securitization)	90	88	88	98	101
	3.22	3.60	3.67	3.38	3.28
	<b>BBB</b>	<b>A-</b>	<b>A-</b>	<b>BBB+</b>	<b>BBB+</b>
<b>Pretax interest coverage (X)</b>					
Income before income taxes	72	195	195	183	169
Interest	183	163	144	133	114
Securitization Interest - Pre-Tax	(93)	(75)	(56)	(35)	(13)
Lease - Interest included as rent	0	0	0	0	0
AFUDC equity	0	0	0	0	0
	162	283	284	281	270
Total interest (incl. capital lease less secure.)	90	88	88	98	101
	1.79	3.21	3.21	2.86	2.68
	<b>BB</b>	<b>BBB+</b>	<b>BBB+</b>	<b>BBB</b>	<b>BBB</b>
<b>Total debt / Total capital (%)</b>					
Total debt (incl cap leases)	1,387	1,418	1,460	1,515	1,549
TOPRs	0	0	0	0	0
Total debt (incl cap leases)	1,387	1,418	1,460	1,515	1,549
<b>Total capital</b>					
Total debt (Excluding Securitization Bonds)	1,387	1,418	1,460	1,515	1,549
Common equity	1,237	1,276	1,315	1,351	1,385
Minority Interest	0	0	0	0	0
Preferred stock (Excluding TOPRs)	51	51	51	51	51
Total Capitalization	2,674	2,744	2,826	2,917	2,985
Adjustment to reduce MI / Pref to 10%	0	0	0	0	0
Total adjusted deb	1,387	1,418	1,460	1,515	1,549
	51.9%	51.7%	51.7%	51.9%	51.9%
	<b>A</b>	<b>A</b>	<b>A</b>	<b>A</b>	<b>A</b>
<b>Net cash flow / Capital expenditures (%)</b>					
Net cash flows	201	228	235	234	230
Less: dividends	(31)	(75)	(75)	(70)	(65)
	170	154	160	164	165
Capital expenditures	166	183	203	217	209
Global Investments	0	0	0	0	0
	166	183	203	217	209
	103%	84%	79%	75%	79%
	<b>A-</b>	<b>BBB</b>	<b>BBB</b>	<b>BBB</b>	<b>BBB</b>

**DOCUMENT**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-00049255**

**DOCKETED**  
JUL 28 2004

**PPL Electric Utilities Corporation**

**Statement No. 10-R**

**Rebuttal Testimony of Julie M. Cannell**

1 **Q. Please state your name and business affiliation.**

2 A. My name is Julie M. Cannell. I am president of J.M. Cannell, Inc.

3

4 **Q. Did you previously submit direct testimony in this proceeding?**

5 A. Yes. My direct testimony (Statement No. 10) was submitted with the filing  
6 by PPL Electric Utilities Corporation (PPL Electric or the Company) on  
7 March 29, 2004.

8

9 **Q. What is the purpose of your rebuttal testimony?**

10 A. I will respond to the return on equity recommendations of the Office of  
11 Trial Staff (OTS) and Office of Consumer Advocate (OCA). As well, I will  
12 address comments of OCA witness Matthew I. Kahal regarding my direct  
13 testimony. In particular, I will address Mr. Kahal's opinions both about the  
14 risk present in a stand-alone distribution company and the focus of  
15 investors.

16

17

### **REBUTTAL SUMMARY**

18 **Q. Please summarize the key points of your rebuttal testimony.**

19 A. The respective 8.75% and 9.5% ROE recommendations of OTS and OCA  
20 do not meet the expectations of investors. Analysts' responses to the  
21 proposals are that they represent a worst-case outcome for the Company,  
22 which is consistent with their view that an equity return in the range of 10-  
23 12% is reasonable. Further, it is likely that investors expect the final ROE

1 award to be at the high end of that range given the fact that interest rates  
2 are rising. Investors, who incorporate interest rates in their forecast of  
3 growth rates, require a higher ROE on their investments during periods of  
4 accelerating interest rates. Should investors' expectations fail to be met in  
5 the case of PPL Electric's potential for growth in earnings and dividends, it  
6 is probable that they would reevaluate their opinion of Pennsylvania  
7 regulation, which ultimately would increase the cost of capital to the  
8 Company and ultimately the cost of service to ratepayers. PPL Electric's  
9 risk profile as a stand-alone distribution company cannot accurately be  
10 compared to the risks it faced as part of an integrated utility, Thus, the  
11 company's risks today cannot be said to be diminished, as suggested by  
12 OCA witness Matthew Kahal in reaching his proposed 9.5% ROE.

#### 14 RETURN ON EQUITY

15 **Q. Please begin by commenting on whether the ROE recommendations**  
16 **of OTS and OCA are consistent with investor expectations.**

17 **A.** OTS Witness Kevan Deardorff proposed an 8.75% ROE and OCA  
18 Witness Michael Kahal, proposed an 9.5% equity return. Neither is  
19 consistent with investors' expectations of an appropriate ROE, as  
20 confirmed in reports issued by a number of analysts, who review the  
21 proposals as a worst case outcome:

22 "PA regulatory staff (adversarial unit) & major intervenor proposed  
23 rate increases more supportive than expected, implying incremental  
24 EPS of \$0.43-\$0.53—right around our estimate. We see this as a

1 worst case scenario, and we think PPL could ultimately receive a  
2 better deal in Dec. final decision or through settlement."  
3 Morgan Stanley June 30, 2004 report: "Raising Price Target,  
4 Ests. On Regulatory Catalysts."  
5  
6

7 **Q. Have investor expectations changed since your direct testimony was**  
8 **filed?**  
9

10 **A.** No, I do not believe so. While the report cited above did not state specific  
11 ROE assumptions, I have no reason to believe the expectations  
12 expressed earlier in the year for a 10-12% ROE, with a bias toward the  
13 upper end of that range, have been lowered. In fact, I think there could be  
14 added support now for a higher ROE in light of the Federal Reserve's  
15 June 29 action to increase interest rates for the first time in a number of  
16 years and the Fed's warning that further increases could be forthcoming  
17 with any additional signs of mounting inflation.  
18

19 **Q. What impact would a disappointing ROE decision likely have on**  
20 **investor perceptions?**

21 **A.** I believe an equity return decision that investors consider to be subpar  
22 would have a very deleterious impact on their perceptions regarding the  
23 Company's earnings and dividend prospects as well as the quality of  
24 Pennsylvania regulation. The current regulatory proceeding is clearly  
25 critically important for the Company's financial well being. Further,  
26 investors are watching this case carefully because it represents the first  
27 post-rate cap case in Pennsylvania and, indeed, one of the first such  
28 cases in the nation. An outcome deemed as being inadequate in meeting

1 investors' requirements for risk compensation most likely would result in a  
2 change in their current positive perceptions of the quality of Pennsylvania  
3 regulation. A negative regulatory perception requires a higher  
4 compensation for risk associated with utilities governed by that regulatory  
5 jurisdiction.

6  
7 **Q. You mentioned that interest rates recently began to rise. Do**  
8 **investors incorporate a consideration of interest rates in their**  
9 **forecasts of earnings and dividends?**

10 **A.** Yes, they do. During times of low interest rates, the ROE investors  
11 require is generally less than during times of rising rates. Thus, the  
12 current climate of accelerating interest rates suggests that, all other things  
13 being equal, an ROE award should be at a higher level than it might have  
14 been when rates were lower. Additionally, the fact that rates are rising  
15 suggests that an additional risk is introduced. If PPL Electric is granted an  
16 ROE materially below the requested level of 11.50% at a time of rising  
17 interest rates, the Company's present dramatic under-earning position  
18 would not be adequately resolved. With unnecessarily weak financials,  
19 the need to access the capital markets could become greater as the risk of  
20 credit downgrades becomes even more pronounced, which in turn would  
21 result in a vicious negative cycle. Further, an inadequate return would  
22 force PPL Electric to return prematurely to the Commission with the need  
23 for another rate increase.

1

2 **Q. Are there any additional comments you would like to offer on return**  
3 **on equity?**

4 **A.** Yes. Investors do not judge their investment returns on the book value of  
5 a company. Rather, returns are premised on the market value, i.e. stock  
6 price. Book value is an historical valuation of a company, while the market  
7 value incorporates investors' perceptions and assessments about the  
8 worth of a company currently.

9

10 **RESPONSE TO OCA WITNESS MATTHEW KAHAL**

11 **Q. Please turn now to Mr. Matthew Kahal's testimony. What is his**  
12 **position regarding PPL Electric's risk level?**

13 **A.** Mr. Kahal believes that there has been a significant decline in the  
14 Company's risk level.

15

16 **Q. Do you agree with his position?**

17 **A.** No. As stated in my pre-filed direct testimony, I believe that PPL Electric  
18 faces various risks today. Those risks stem from a number of factors, and  
19 their magnitude cannot be directly compared, and thus not relatively  
20 gauged, to what the Company's risk level was when it was an integrated  
21 utility company.

22

1 **Q. What specific risks does Mr. Kahal believe not to be applicable to the**  
2 **Company?**

3 **A.** He considers risks related to RTOs and transmission policies, provider of  
4 last resort obligations, lack of diversification, and bypass threat not  
5 applicable to PPL Electric.  
6

7 **Q. What does he say about RTO and transmission uncertainty?**

8 **A.** Mr. Kahal notes that PPL Electric is a member of the PJM Interconnection,  
9 which he characterizes as being "widely regarded by both the industry and  
10 its regulators as the most successful RTO in the United States." He then  
11 opines that the current rate proceeding "addresses distribution service,  
12 and we are not addressing the cost of capital for the Company's  
13 transmission investment."  
14

15 **Q. Please comment on Mr. Kahal's observations about RTO and**  
16 **transmission uncertainty.**

17 **A.** I agree that the PJM Interconnection has functioned successfully for a  
18 *number of years and that this success has led other regions of the country*  
19 *to adopt portions of its framework in the process of constructing their own*  
20 *deregulated marketplaces. However, PJM is in the process of expanding*  
21 *and merging with the Midwest ISO (MISO). This expansion has raised*  
22 *concerns over the uncertainty the new configuration raises. These*  
23 *concerns have centered around, but are not limited to, reliability issues;*

1 specifically, will the "seams" between PJM and MISO be smooth, or could  
2 transmission disruptions occur? Should the new entity experience  
3 *reliability problems, PPL Electric could well be impacted. As to Mr.*  
4 Kahal's noting that "this case addresses distribution service, and we are  
5 not addressing the cost of capital for the Company's transmission  
6 investment," I agree; the case does, and we are not. One of the issues  
7 the proceeding *is* addressing, however, is the cost of equity of PPL  
8 Electric, and that requires an assessment of risk factors that should be  
9 factored into the equity return. I reiterate my opinion that, the Company,  
10 as a stand-alone distribution utility, faces uncertainties regarding RTOs  
11 and transmission policies. Those uncertainties may not be unique to PPL  
12 Electric, but they remain uncertainties that impact it nonetheless.

13  
14 **Q. What are Mr. Kahal's observations about "single line of business" or**  
15 **asset concentration?**

16 A. He believes that PPL Electric does not have asset concentration "because  
17 *no single asset accounts for a large percentage of its total investment.*  
18 With respect to the asset concentration problem, PPLEU is much less  
19 risky than the former vertically-integrated PP&L."

20  
21 **Q. Do you agree with Mr. Kahal's opinion?**

22 A. No. In PPL Electric's situation, all the Company's assets are related to the  
23 distribution business. In my estimation, that fully qualifies as asset

1 concentration. If problems arise so that, for whatever reason, those  
2 distribution assets are unable to perform their prescribed function, the  
3 Company is completely exposed. As to his assertion that the Company's  
4 present risk is less compared to the former vertically integrated PP&L, my  
5 setting forth risk factors related to PPL Electric today neither compared  
6 nor intended to compare the present risks with what existed in the prior  
7 corporate configuration. The issue is the stand-alone distribution  
8 company that exists today, not what formerly existed.

9  
10 **Q. Mr. Kahal expressed an opinion regarding PPL Electric's economic**  
11 **exposure. Do you agree with him?**

12 **A.** No. His view is that a local market downturn would also translate into a  
13 regional market downturn. Further, he opined that wholesale market sales  
14 would not prop up earnings in a downturn scenario, because short-term  
15 sales margins (in a fully integrated paradigm) would be returned to  
16 ratepayers. I believe Mr. Kahal missed my point, which is that the  
17 opportunity to participate in the wholesale market doesn't necessarily  
18 provide greater net revenue *stability*; rather, it provides at least another  
19 avenue for revenues to offset less demand in the service territory. My  
20 *assumption is not that the wholesale market would remain unchanged in*  
21 *an economic downturn. Instead, the market has the potential to offer a*  
22 *chance for incremental revenues. In contrast, if a customer is lost on the*

1 retail system during an economic downturn, it is unlikely that there would  
2 be an opportunity to offset even a portion of that loss in revenues.

3  
4 **Q. What are Mr. Kahal's views about bypass posing a threat to the  
5 Company?**

6 **A.** He does not believe a threat has existed or will exist.

7  
8 **Q. Do you agree?**

9 **A.** No, because the Company has already experienced such a danger. A  
10 recent example is in the Borough of Olyphant, where the Borough is  
11 proposing to begin providing retail electric service to customers located in  
12 an industrial park currently served by PPL Electric. If the Borough  
13 is successful in these efforts, PPL Electric could lose a number of these  
14 industrial customers. Another example is in Lycoming County where the  
15 local landfill authority is proposing to build a new generating facility to  
16 serve an adjacent federal prison facility. Finally, PPL Electric customers  
17 have installed onsite generation, suggesting this factor was a risk in the  
18 past and will continue to be a risk in the future.

19  
20 **Q. Mr. Kahal offered commentary about PPL Electric's provider of last  
21 resort (POLR) arrangement. Please share his views and your opinion  
22 of them.**

1 A. Mr. Kahal claimed that my testimony “fails to recognize PPLEU’s current  
2 low-risk arrangements for POLR service.” That is incorrect. While I did  
3 not specifically comment on the plan, I fully agree that PPL Electric’s  
4 current POLR arrangement is constructive and that the Company has  
5 acted appropriately to limit its risk. But it is not completely risk-free.  
6 Consider the fact that the Company made a \$90 million payment to PPL  
7 *EnergyPlus* in exchange for the guarantee of supply through 2008. PPL  
8 Electric has agreed not to seek recovery of the \$90 million payment from  
9 customers. Nevertheless, investors recognize that there are risks of  
10 providing POLR service during and after the expiration of generation rate  
11 caps. The fact that PPL Electric acted to limit such risk does not eliminate  
12 the risk or indicate that it is not appropriately reflected in the cost of equity.

13  
14 **Q. What else did Mr. Kahal have to say about POLR?**

15 A. He went on to opine that it was “possible but not very likely” that POLR  
16 obligations could be a significant risk after 2009. Additionally, he said  
17 other distribution utilities have “implemented procurement plans for POLR  
18 supply without incurring significant risk exposure” and that POLR risk, if it  
19 exists, “should be reflected in the POLR rates, not the distribution rates.” I  
20 do not agree with those assertions. It is pure speculation on Mr. Kahal’s  
21 part that POLR obligations are not very likely to be a risk beyond 2009.  
22 Investors will soon begin to incorporate the post-2009 period into their  
23 long-term projections. With no certainty of what the Company’s

1 obligations will be at that time, they will require a higher premium as  
2 compensation for that potential risk.

3  
4 **Q. Did Mr. Kahal offer additional observations about POLR with which  
5 you disagree?**

6 **A.** Yes. Mr. Kahal's blanket statement that the POLR situation in other states  
7 is unproblematic is incorrect. An example of a current challenging  
8 situation exists in the state of Michigan regarding Detroit Edison. Under  
9 Michigan's "Retail Choice" law, that company has experienced a rapid loss  
10 of a significant proportion of its commercial and light industrial customers,  
11 all of whom can return to POLR service at a time of their own choosing  
12 without penalty or mark-up. This unrestricted right of return constitutes a  
13 valuable option in the hands of the departing customers, the cost of which  
14 is borne by the remaining customers of Detroit Edison and by the  
15 shareholders. The optionality is created by the volatile market conditions  
16 and the "free" right of customers to play that market by departing from and  
17 returning to POLR. Further, the issue of POLR supply procurement is  
18 more complex than Mr. Kahal suggests. The nation has generally enjoyed  
19 an over-supply situation for a period of years; ample supply translates into  
20 lower prices for market power. But as the supply situation begins to  
21 tighten, which it assuredly will do in some regional pockets, or if delivery  
22 options are threatened due to changes in RTOs or other transmission  
23 issues, costs will rise. In addition to supply-induced price increases, many

1 of the power markets in this country have experienced sharp price  
2 increases this year as a result of natural gas price increases. This is  
3 because natural gas generation is the marginal generation source in much  
4 of the country, much of the time, including PJM. Unless there is a  
5 guaranteed supply and guaranteed cost recovery for providing that supply  
6 in a POLR plan, the stand-alone distribution company is at risk. The  
7 potential exists for PPL Electric to be exposed to such risk in the future.  
8

9 **Q. What further opinions regarding POLR did Mr. Kahal offer?**

10 **A.** Mr. Kahal contends that POLR-related risks should be reflected in POLR  
11 rates, not distribution rates. I believe he misses a point. The issue he  
12 was addressing at that point in his testimony was the risks facing a stand-  
13 alone distribution company. Investors demand compensation for taking  
14 risks associated with an investment, and their compensation is in the form  
15 of an ROE that permits a company reasonable opportunity to grow  
16 earnings and dividends. If POLR costs are not recovered, those  
17 opportunities will be reduced. The current and post-2009 period presents  
18 POLR risks to PPL Electric, which, from the perspective of investors, is a  
19 risk in this distribution case.  
20

21 **Q. Did Mr. Kahal's testimony offer additional opinions on which you**  
22 **would like to comment?**

1 A. Yes. Mr. Kahal claims I suggested that the Commission should focus on  
2 the Company's stock price. I made no such suggestion, and would not.  
3 Stock prices are not something that can be directly controlled. Rather,  
4 they serve as a *reflection* of investors' value perceptions about a  
5 company. Investors typically assign a stock target price. That target  
6 represents their appraisal of the full valuation of the stock, and thus a price  
7 at which they might wish to sell. Target prices, of course, can be adjusted  
8 with a change in a company's fundamental circumstances or to reflect  
9 changing market conditions. A key factor that investors would consider in  
10 assigning a target price is the quality of Pennsylvania regulation.

11

12 Q. **Does this complete your rebuttal testimony?**

13 A. Yes.