

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :  
COMMISSION :  
 : DOCKET NO. R-2014-2428743  
v. :  
 :  
PENNSYLVANIA ELECTRIC COMPANY :

SURREBUTTAL TESTIMONY

OF

RALPH C. SMITH

ON BEHALF OF THE

PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE

**PROPRIETARY INFORMATION HAS BEEN DELETED**

JANAURY 6, 2015

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## Exhibits

LA-4, Calculation of Consolidated Tax Savings Using 2012 and 2013 FirstEnergy consolidated income tax return information (Contains FirstEnergy Confidential Information)

1 **I. INTRODUCTION**

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

3 A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates,  
4 PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

5  
6 **Q. Are you the same Ralph C. Smith who filed Direct and Rebuttal Testimony in**  
7 **this case on behalf of the Pennsylvania Office of Consumer Advocate (“OCA”)**  
8 **to review the rate requests of the FirstEnergy electric distribution utilities**  
9 **(“FE” or “Companies”)?**

10 A. Yes. I filed Direct Testimony in this case on behalf of the OCA on November 24,  
11 2014 concerning revenue requirement and accounting issues for the four FirstEnergy  
12 Pennsylvania electric distribution utilities, Metropolitan Edison Company (“Met-Ed”  
13 or “ME”), Pennsylvania Electric Company (“Penelec” or “PN”), Pennsylvania  
14 Power Company (“Penn Power” or “PP”), and West Penn Power Company (“West  
15 Penn” or “WP”), (collectively "Companies"). I also filed rebuttal testimony in this  
16 case on behalf the OCA on December 18, 2014 on storm damage reserve and  
17 surcharge issues.

18

19 **Q. What is the purpose of your Surrebuttal Testimony?**

20 A. The purpose of my Surrebuttal Testimony is to respond to certain recommendations  
21 in the rebuttal testimony of FirstEnergy witnesses Richard D’Angelo and Patricia  
22 Larkin.

23

1 **Q. Have you attached any Exhibits to your Surrebuttal Testimony?**

2 A. Yes. Exhibit LA-4 shows a Calculation of Consolidated Tax Savings Using 2012  
3 and 2013 FirstEnergy consolidated tax return information. This calculation is made  
4 in response to FirstEnergy witness D'Angelo's rebuttal testimony which claims that  
5 2011 was abnormal because it reflected impacts from 100% bonus tax depreciation,  
6 as discussed below in Section IX of my surrebuttal testimony. Exhibit LA-4  
7 contains FirstEnergy confidential information.

8

9 **Q. How is your Surrebuttal Testimony organized?**

10 A. It is organized by issue group. Each section discusses a particular issue or group of  
11 issues which is being contested in FirstEnergy's rebuttal testimony.

12

13 **Q. Are you revising the revenue requirement recommendations made in your  
14 direct testimony at this time?**

15 A. No, I am not.

16

17 **Q. Should any inference be made about OCA agreement with a FirstEnergy  
18 proposal if it is not addressed in your Surrebuttal Testimony?**

19 A. No. The procedural schedule for the case did not provide much time between  
20 FirstEnergy's rebuttal filing and the filing date for OCA surrebuttal. Silence in my  
21 Surrebuttal Testimony on any particular issues or FirstEnergy proposals should not  
22 be taken as any kind of inference of OCA agreement.

23

1 **II. AVERAGE RATE BASE/AVERAGE TEST YEAR CONCEPT**  
2 **APPLIED TO FULLY PROJECTED FUTURE TEST YEAR**

3 **Q. Did Mr. D'Angelo agree with your recommendation that rate base for the fully**  
4 **projected future test year should be computed on an average test year basis?**

5 A. No. Mr. D'Angelo does not agree with my recommendation to use an average rate  
6 base for the fully projected future test year ("FPFTY") ending April 30, 2016  
7 because he claims that this method has not been endorsed by the Pennsylvania Public  
8 Utility Commission ("Commission") and there is no provision for averaging rate  
9 base in Act 11. He also notes that the Companies have annualized revenue to reflect  
10 FPFTY year-end customer counts.

11  
12 **Q. Has the Company identified any orders from the Pennsylvania Commission**  
13 **where the determination of a FPFTY rate base has been addressed?**

14 A. No. The Companies' response to OCA data requests ME XXI-6, PE-XXI-5, PP-  
15 XXI-5 and WP-XXI-5 each indicates that: "The Company is not aware of any orders  
16 that address the determination of a FPFTY rate base."

17  
18 **Q. How is the determination of a FPFTY rate base typically addressed in other**  
19 **states in which a FPFTY is used?**

20 A. Based on my experience, in other states where a FPFTY test year is used, the FPFTY  
21 is treated as the first year of new rates, and an average test year concept is applied.

22  
23 **Q. Why is an average test year concept commonly applied when a FPFTY test year**  
24 **is used?**

1 A. Where a FPFTY is used, the FPFTY is commonly viewed as the first year in which  
2 the new rates will be in effect. In order to achieve matching of the revenue  
3 requirement with the first year of new rates, the rate base for the FPFTY reflects and  
4 should be based on the average for the fully projected future test year period, rather  
5 than upon values as of a single date, such as at the very end of the FPFTY. The use  
6 of an average FPFTY properly matches the collection of the revenue requirement  
7 during the first year of new rates, i.e. with the FPFTY. For the FirstEnergy electric  
8 utilities, in the current rate cases, the FPFTY corresponds with the first year of new  
9 rates, and it is therefore consistent to apply the average test year concept for the  
10 FPFTY beginning on May 1, 2015 and continuing through April 30, 2016.

11  
12 **Q. Is the use of a FPFTY that corresponds with the first year of new rates different**  
13 **from the approach that is commonly used with a test year that ends before the**  
14 **commencement date for new rates?**

15 A. Yes. The FPFTY extends further into the future, i.e., and covers the first year of new  
16 rates. This is different conceptually than using a test year that ends prior to the  
17 effective date of new rates. The approach that is commonly used with a test year that  
18 ends before the commencement date for new rates is to reflect annualization  
19 adjustments occurring during and in some circumstances beyond the end of the test  
20 year, in order to better "match" the revenue requirement with the level of operations  
21 that is anticipated for the first year of new rates.

22 In contrast, the FPFTY, on average, matches the revenue requirement with  
23 the level of operations that is anticipated for the first year of new rates. Thus,

1 annualization adjustments, such as the use of year-end rate base, or annualizations of  
2 expenses to year-end conditions, that are fairly common with test years that end  
3 before the effective date of new rates, are not consistent with the concept of having  
4 the FPFTY match the revenue requirement that is anticipated for the first year of  
5 new rates.

6  
7 **Q. How did you acquire your understanding of how other jurisdictions that use**  
8 **FPFTYs apply the average test year concept?**

9 A. I acquired my understanding of how a number of other jurisdictions that use FPFTYs  
10 apply the average test year concept in conjunction with their use of FPFTYs as an  
11 analyst and expert witness in a number of utility rate cases in such jurisdictions, as  
12 described below<sup>1</sup>. Based on my knowledge and experience, state regulatory  
13 jurisdictions with which I am familiar in which utilities have used a fully projected  
14 future test year and an average test year concept for purposes of test year measuring  
15 rate base and to determine the utility's revenue requirement include California,  
16 Hawaii, Georgia, Illinois and Kentucky. I did not perform a special study or survey  
17 on this topic in preparation for filing my direct or surrebuttal testimony, and this  
18 information is based on my recollection from participating as an analyst and/or  
19 expert witness, that some or all of the cases listed below used a fully projected test  
20 year and an average test year rate base:

- 21 • San Diego Gas & Electric, California PUC Application No. 10-12-005,  
22 forecast average test year ending December 31, 2012.
- 23 • California-American Water Company, California PUC Application No.  
24 10-07-007, forecast average test year ending December 31, 2012.

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<sup>1</sup> This was also previously provided to FirstEnergy in response to one of their data requests to OCA.

- 1 • Hawaiian Electric Company, Hawaii PUC Case Nos. 2008-0083 and  
2 2010-0080.
- 3 • Georgia Power Company, Georgia PSC Docket No. 31959 (2010 rate  
4 case) and Docket No. 36989 (2013 rate case), average future test years  
5 used for forecast test year and forecast utility proposed rate plan years  
6 used for rate base determination.
- 7 • Illinois American Water Company, Illinois Commerce Commission Case  
8 No. 11-0767, proposed general increase in water and sewer rates, forecast  
9 average test year ending September 30, 2013.
- 10 • Kentucky American Water Company, Kentucky PSC Docket No. Case  
11 No. 2010-00036, forecast average test year ending September 30, 2011.

12  
13 **Q. Do you agree with Mr. D'Angelo in theory that if the FPFTY rate base is**  
14 **computed using an average test year basis, that revenues for the FPFTY should**  
15 **be consistent?**

16 **A. Yes. The Companies' filing reflected the following adjustments to annualize FPFTY**  
17 **revenues to year-end April 30, 2016:**

- 18 • \$502,000 increase for Met-Ed
- 19 • \$408,000 increase for Penelec
- 20 • \$117,000 increase for Penn Power
- 21 • \$338,000 increase for West Penn.

22 If the FPFTY rate base is computed using an average test year basis, I would  
23 not oppose the removal of these April 30, 2016, year-end revenue annualization  
24 adjustments in order to reflect a consistent application of the average test year  
25 concept to the FPFTY. The application of an average test year concept, as noted  
26 above, is consistent with treating the FPFTY as the first year of new rates. Thus,  
27 annualizations of revenues or expenses to end-of-FPFTY conditions should not be  
28 made because they are inconsistent with this concept of matching the FPFTY  
29 revenue requirement with the cost of service during the first year of new rates. As

1 noted above, in the introduction to my surrebuttal testimony, I have not at this time  
2 updated any of the OCA revenue requirement schedules to reflect the removal of  
3 these FirstEnergy revenue annualization adjustments. Removal of such revenue  
4 adjustments would tend to increase the revenue deficiency for each FirstEnergy  
5 utility by the same approximate amount of the revenue adjustment that is being  
6 removed.

7  
8 **Q. Are any other adjustments affected by the application of the average test year**  
9 **concept to the FPFTY?**

10 A. Yes. The Companies' proposed annualizations of certain pay increases, and related  
11 adjustments to employee benefits, are also affected by the application of the average  
12 test year concept to the FPFTY. These adjustments were reflected on Schedules C-6,  
13 C-7 and C-8 in the OCA's revenue requirement exhibits that were filed with my  
14 direct testimony.

15  
16 **Q. Has FirstEnergy identified any Commission orders that address the ratemaking**  
17 **treatment of pay increases that become effective during or subsequent to a**  
18 **FPFTY?**

19 A. No. For example, FirstEnergy's response to OCA PN-XXI-12 (and similar  
20 interrogatories to the other FirstEnergy utilities) states that: "The Company is not  
21 aware of Commission orders that address the ratemaking treatment of pay increases  
22 that become effective during a FPFTY."

1 **Q. Please summarize your recommendation concerning applying the average test**  
2 **year concept to the FPFTY.**

3 A. As described in my direct testimony and herein, the use of a FPFTY that corresponds  
4 with the first year of new rates is conceptually consistent with an average test year  
5 approach, which achieves proper matching of the revenue requirement to be in effect  
6 during the first year of new rates. The application of the FPFTY rate base and  
7 operating income in this manner, i.e., on an average test year basis, is also consistent  
8 with my understanding of how rate base and operating income is commonly  
9 determined in conjunction with the use of FPFTYs in other jurisdictions where  
10 FPFTYs are used.

11

12 **III. STORM DAMAGE COSTS AND STORM RESERVE ACCRUALS**

13 **Q. Have you revised your position on storm damage expense as a result of**  
14 **FirstEnergy's rebuttal testimony?**

15 A. No. The same recommendations concerning storm damage expense that are  
16 reflected in my direct testimony and exhibits continue to apply.

17

18 **Q. At pages 24-25 of his rebuttal testimony in Met-Ed (and similar rebuttal**  
19 **testimony for the other three FirstEnergy utilities), FirstEnergy witness**  
20 **D'Angelo claims that your recommendation of a ten-year amortization period**  
21 **for deferred storm costs and the amortization commencement date is contrary**  
22 **to the express language of the Commission's deferral orders. He also claims**

1           **your recommendation would deny the Company recovery of a significant**  
2           **component of its deferred costs. Please respond.**

3       A.     FirstEnergy appears to be bootstrapping selected language that simply allowed it to  
4           seek recovery, into an inference that recovery has been somehow preapproved. As  
5           described in my direct testimony, where the Commission's storm cost deferral orders  
6           have indicated that the amortization period should commence with the effective date  
7           of the Commission order, consistent with those directives, I have reflected those  
8           dates for the commencement of the amortization period. This is specifically  
9           consistent with the Commission's accounting and deferral orders. It is not contrary  
10          to those orders, as claimed by Mr. D'Angelo.

11                        Additionally, for the storm cost deferrals where a specific amortization  
12           commencement date was not specified in a Commission order, the amortization was  
13           commenced consistent with the expiration of the related rate moratorium. In those  
14           situations, using the rate moratorium expiration date as the commencement date for  
15           the deferred storm cost amortization is fair and reasonable and has not deprived the  
16           Companies of any cost recovery, since they could have sought a rate increase  
17           consistent with the expiration of the rate moratorium.

18                        Mr. D'Angelo claims (e.g., at page 25 of his Met-Ed rebuttal)<sup>2</sup> that the  
19           Commission's Order "does not preclude Metropolitan Edison Company from seeking  
20           recovery of the total amount of its deferred expenses." That statement in the Order  
21           simply does not preclude FirstEnergy from seeking that cost recovery. The Order  
22           does not provide approval in advance or guarantee such cost recovery, nor does it

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<sup>2</sup> FirstEnergy rebuttal for the other Companies on storm damage deferral and related amortization is similar, reflecting the specific facts affecting each utility and its storm expenses.

1 preclude any other reasonable method of amortizing the deferred storm expenses for  
2 ratemaking purposes. It merely authorizes FirstEnergy to seek approval.

3 The issues related to the appropriate amortization period for ratemaking  
4 purposes are being addressed in the current FirstEnergy rate cases, and were not  
5 predetermined by the Commission's accounting deferral order for the storm costs.

6 Contrary to the implications of Mr. D'Angelo's rebuttal on this issue, my  
7 testimony is not in any manner alleging that FirstEnergy was somehow precluded  
8 from seeking cost recovery. Rather, it recognizes that FirstEnergy has the right to  
9 seek recovery of the total amount of deferred storm costs and in fact has done so in  
10 the current rate case. It also recognizes that, given the amortization commencement  
11 dates that apply for accounting purposes and the time that has elapsed during the  
12 intervening period when FirstEnergy could have sought rate recovery, the specific  
13 cost recovery being sought by FirstEnergy should be adjusted for the reasons  
14 described in my direct testimony in the manner described therein.

15 Recognizing deferred storm cost amortization for accounting and ratemaking  
16 purposes starting with the dates specified in the Commission's orders or with the rate  
17 moratorium expiration dates for the storm deferrals where no amortization  
18 commencement date was specified in a Commission order is a fair and appropriate  
19 treatment for ratemaking purposes, and, as far as I can tell, is not contrary to or  
20 inconsistent with any of the storm expense accounting deferral orders. It simply  
21 reflects appropriate ratemaking after reviewing the facts. The facts include the per  
22 book amortizations that FirstEnergy has been recording for the storm amortizations.

23 The facts also include that FirstEnergy could have sought recovery of storm costs by

1 filing base rate cases sooner than it did. The fact that FirstEnergy chose the timing  
2 of its current round of rate cases and thereby delayed making its request for deferred  
3 storm cost recovery needs to be considered. I have considered these facts and have  
4 made the fair and equitable recommendations for the treatment of deferred storm  
5 costs described in my direct testimony.

6  
7 **Q. The FirstEnergy rebuttal testimony indicates that the Companies are adopting**  
8 **a five-year average of storm damage expenses and a storm reserve accrual**  
9 **approach, based on their acceptance of the recommendations of I&E witness**  
10 **Boyd. Do you agree with that approach?**

11 A. No. As described in my rebuttal testimony filed on December 18, 2014, OCA is not  
12 categorically opposed to the establishment of a storm damage reserve account if  
13 shown that such an accounting mechanism is necessary, but in the current  
14 FirstEnergy rate cases, it has not been shown to be necessary. Additionally, as  
15 described in my rebuttal testimony, OCA opposes certain aspects of the functioning  
16 of a storm reserve approach, which appear to be encompassed within I&E witness  
17 Boyd's recommendations, such as funding the storm damage reserve with a  
18 surcharge.

19  
20 **Q. If a storm reserve accrual approach were to be adopted in the current**  
21 **FirstEnergy rate cases, is a five-year average of storm costs, excluding**  
22 **extraordinary storms, one way to establish a reserve accrual level?**

1 A. Yes. As described in my rebuttal testimony, if a storm reserve is to be established,  
2 the establishment of a storm reserve with an upper limit equal to a five-year average  
3 of Company actual storm expenses (and excluding costs for extraordinary storms)  
4 could be one reasonable way to establish a storm reserve.

5

6 **Q. If a five-year average of storm expenses were to be used to establish a storm**  
7 **reserve, should the five-year average exclude costs for extraordinary storms?**

8 A. Yes. As described in my rebuttal testimony, if a five-year average of storm expenses  
9 were to be used to establish a storm reserve, the average should reflect expenses for  
10 all storm events except for "extraordinary" storms, i.e., the cost of "extraordinary"  
11 storms should be excluded from an average that is used for this purpose.

12

13 **Q. Do the five-year averages of storm expense proposed by I&E witness Boyd,**  
14 **which have apparently been accepted by FirstEnergy, include extraordinary**  
15 **storm costs?**

16 A. Yes. As shown in FirstEnergy's response to OCA ME XXI-4 and summarized  
17 below, the five-year average storm expense for Met-Ed includes \$21.497 million of  
18 storm cost for Hurricane Sandy, which was an extraordinary storm:

Year	Storm related O&M	Extraordinary Storms	Storm related O&M
2009	\$ 7,075,372		\$ 7,075,372
2010	12,760,136		12,760,136
2011	34,827,259		34,827,259
2012	32,594,558	21,497,000	11,097,558
2013	1,208,183		1,208,183
5 year average	<u>\$ 17,693,102</u>		<u>\$ 13,393,702</u>

Sandy was Docket No. P-2013-2351260 (Met-Ed RAD-2, page 24)

1

2

Similarly, as shown in FirstEnergy's response to OCA WP-XXI-4 and

3

summarized below, the five-year average storm expense for West Penn includes

4

\$15.465 million of storm cost for an extraordinary 2010 winter ice storm:

Year	Storm related O&M	Extraordinary Storms	Storm related O&M
2009	\$ 11,805,992	\$ -	\$ 11,805,992
2010	27,358,925	15,464,953	11,893,972
2011	9,972,606	-	9,972,606
2012	6,772,601	-	6,772,601
2013	4,813,528	-	4,813,528
5 year average	<u>\$ 12,144,730</u>		<u>\$ 9,051,740</u>

\*February 5-16, 2010 Winter Storm deferral approved at Docket No. P-2010-2216111

5

6 **Q.**

**What about for the other two FirstEnergy utilities, Penelec and Penn Power?**

7 **A.**

FirstEnergy's responses to similar OCA discovery for the other two utilities, Penelec

8

and Penn Power, did not identify any cost for extraordinary storms that were

9

included in the five-year average.

10

11 **Q.**

**If a five-year average of storm expenses were to be used to establish a storm**

12

**reserve, should the five-year average exclude costs for extraordinary storms?**

1 A. As described above and in my rebuttal testimony, if a five-year average of storm  
2 expenses were to be used to establish a storm reserve, the average should reflect  
3 expenses for all storm events except for "extraordinary" storms, i.e., the cost of  
4 "extraordinary" storms should be excluded from an average that is used for this  
5 purpose.

6

7 **Q. Please summarize your recommendations concerning how storm costs should be**  
8 **reflected in the FPFTY revenue requirement.**

9 A. As described in my direct testimony, no amounts of deferred storm cost should be  
10 included in rate base, because this is an operating expense not an investment.  
11 Additionally, if any amounts were to be considered for inclusion in FPFTY rate base,  
12 the amounts would need to be reduced by amortization occurring prior to and during  
13 the FPFTY. The FirstEnergy utilities have not done this for any of their requested  
14 rate base inclusions of deferred storm cost. The Companies' requests to include  
15 deferred storm cost in rate base should be rejected.

16 Concerning the amortization of storm costs as an operating expense, as  
17 described in my direct testimony and above, the amortization periods for each  
18 deferred storm cost should be treated as commencing prior to the beginning of the  
19 FPFTY, i.e., at the dates described in my direct testimony. The amortization  
20 expense for each component of deferred storm expenses to be included in the FPFTY  
21 should be based on continuing a ten-year average amortization schedule, as  
22 described in my direct testimony.

23

1 **Q. Please summarize your recommendations concerning whether a storm reserve**  
2 **should be established.**

3 A. As described in my rebuttal testimony and above, a compelling need in the current  
4 FirstEnergy rate cases to establish a storm reserve account has not been established,  
5 and thus I do not recommend that one be established for these utilities in the current  
6 rate cases. The traditional procedure of having utilities apply for deferred  
7 accounting for extraordinary storms has functioned acceptably, and there is no  
8 compelling need to establish a new reserve for storm costs. I therefore recommend  
9 that the Companies' request for a storm reserve accrual, and the related I&E  
10 recommendation for establishing a storm reserve, be rejected.

11

12 **Q. Please summarize your recommendations concerning how a storm reserve**  
13 **should function if one were to be approved in the current FirstEnergy rate**  
14 **cases.**

15 A. As described in my rebuttal testimony and herein, if a storm reserve is to be  
16 established, the establishment of a storm reserve with an upper limit equal to a five-  
17 year average of Company actual storm expenses (and excluding costs for  
18 extraordinary storms) could be one reasonable way to establish a storm reserve.

19 As described in my rebuttal testimony, there should be no surcharge  
20 associated with a storm reserve.

21 Additionally, the storm damage reserve account should function similarly to  
22 an Injuries and Damages reserve account that has been used in ratemaking in the  
23 past. Expense accruals for storm damage would be recorded to build up a reserve,

1 and costs would be charged against the reserve account when incurred. The reserve  
2 account and the level of costs would be reviewed in the utility's base rate cases.  
3 Amounts over or under the funding level in the reserve account are addressed in the  
4 subsequent base rate case. There would not be any related surcharge, and the annual  
5 accrual amounts would not be adjusted between utility base rate cases. Issues  
6 concerning the determination of a normalized amount of storm costs would be  
7 addressed periodically in utility base rate cases.

8  
9 **Q. Please summarize your recommendations concerning procedures that would**  
10 **apply prospectively if one or more of these FirstEnergy utilities experiences an**  
11 **extraordinary storm during the period between rate cases.**

12 **A.** As described in my rebuttal testimony, if a utility experiences an extraordinary storm  
13 during the period between rate cases, the same standard procedure that has been used  
14 in Pennsylvania for decades would continue to apply. That procedure involves the  
15 utility submitting a petition to the Commission for deferred accounting for  
16 extraordinary storm damage. As history has shown, the PUC typically approves  
17 these petitions for deferred accounting, but cautions that no decision is being made at  
18 that time as to whether those costs can actually be collected in the utility's next base  
19 rate case. In response to such utility deferral petitions, the Commission has  
20 traditionally only approved the utility's ability to defer the costs and to seek recovery  
21 in the next base rate case. To address recovery of storm costs, as was done in these  
22 current FirstEnergy utility rate cases, the utility files a base rate case and seeks to

1 collect those costs over some amortization period, and the issues concerning storm  
2 cost recovery are addressed in the utility's base rate case.

3  
4 **IV. RATE CASE EXPENSES**

5 **Q. What is FirstEnergy's rebuttal position concerning the rate case expense**  
6 **amortization period?**

7 A. FirstEnergy witness D'Angelo's rebuttal testimony claims that the Companies' past  
8 filing frequency was impacted by a rate cap or rate freeze, which limited its ability to  
9 file a base rate case.<sup>3</sup> He also cites limitations on cost recovery through a  
10 distribution system improvement charge ("DSIC"), and states that the Company  
11 believes it is reasonable to assume that henceforth it will be filing rate cases with  
12 increased frequency.

13  
14 **Q. In theory, wouldn't having a DSIC tend to extend the time between base rate**  
15 **cases, rather than shorten it?**

16 A. Yes. Other things being equal, having an opportunity to recover certain  
17 infrastructure costs through a DSIC between rate cases should extend the time  
18 between rate cases, not shorten it. To the extent that these FirstEnergy utilities have  
19 not used DSIC surcharges historically but would be using them prospectively, the  
20 addition of the DSIC-based recovery of infrastructure investments should not be  
21 expected to shorten the time between rate case filings.

22  

---

<sup>3</sup> See, e.g., D'Angelo rebuttal in Met-Ed (Company Statement 2-R), pages 20-21.

1 **Q. Are you revising your recommendation concerning the rate case expense**  
2 **amortization period based on the FirstEnergy rebuttal concerning this?**

3 **A.** No. As described in my direct testimony, FirstEnergy presented similar arguments in  
4 the last Met-Ed and Penelec rate cases, and those arguments for a shorter  
5 amortization period for rate case cost were rejected because the Companies had not  
6 actually established a more frequent base rate case filing schedule. In Met-Ed's and  
7 Penelec's last base rate cases in Docket Nos. R-00061366 and R-00061367, Met-Ed  
8 and Penelec had proposed a three-year recovery period for rate case expense. The  
9 Commission's Final Order dated January 11, 2007 stated in part that:

10 . . . [R]ate caps prevented a rate case filing in the last decade;  
11 however, a review of the filing frequency before the  
12 implementation of the rate caps reveals that the Companies  
13 had unusually long intervals between rate case filings. . . .  
14 Although it is convenient to use the rate caps as a justification  
15 for an expedited recovery period, **a three year recovery**  
16 **period is unwarranted given ME's and PN's history of long**  
17 **stay outs between rate case filings.**

18 **Second, the Companies assertion that there is a "greater**  
19 **likelihood" of more frequent filings now that the rate caps**  
20 **have expired is merely a statement of future intentions,**  
21 **which is highly speculative. The Commission relies on**  
22 **filing history because that history is the most reliable**  
23 **barometer of when future rate cases will be filed. The**  
24 **filing history of MEPN does not support a three year filing**  
25 **cycle. The Companies' request to ignore those facts and**  
26 **instead rely on unpredictable future intentions must be**  
27 **rejected.**

28 Finally, the Companies' reliance on the PPL case is wholly  
29 irrelevant because **normalization periods are specific to**  
30 **each company and are based on the historic frequency of**  
31 **base rate case filings.**

32 (Emphasis supplied.)

33

1           As noted above, the Commission's Final Order in the above referenced prior  
2 dockets was dated January 11, 2007, or over seven years from August 4, 2014, i.e.,  
3 from the filing date of the Companies' rate case filings in the current proceedings. In  
4 addition, Penn Power's last rate case filing was in Docket No. R-870732, filed  
5 August 5, 1987 and with the Final Order issued May 3, 1988.<sup>4</sup> Moreover, West  
6 Penn's last rate case filing was in Docket No. R-00973981 with the Final Order  
7 issued November 19, 1998. Thus, it appears that the Companies' trend of relatively  
8 infrequent rate case filings has not changed. As such, a two-year normalization  
9 period for recovery of rate case expense in the current proceedings is unwarranted  
10 and should be rejected. I continue to recommend that the Company's claimed rate  
11 case expense be normalized over a period of five years.

12  
13 **V. PENSION EXPENSE**

14 **Q. What do the FirstEnergy Companies recommend in their rebuttal testimony**  
15 **concerning pension expense?**

16 A. They continue to request that pension expense be based on a ten-year average of  
17 cash funding contributions.<sup>5</sup> Their position appears to be heavily reliant upon the  
18 Commission accepting a ten-year average of cash contributions approach in the last  
19 Met-Ed and Penelec rate cases.

20  
21 **Q. In your experience, what is the most common method of reflecting pension**  
22 **expense for ratemaking purposes?**

---

<sup>4</sup> See the response to I&E PP-RE-4-D.

<sup>5</sup> See, e.g., D'Angelo rebuttal in Met-Ed (Company Statement 2-R), pages 21-23.

1 A. In my experience, the most common method of reflecting pension expense for  
2 ratemaking purposes is based on generally accepted accounting principle ("GAAP")  
3 based accruals, based on Statement of Financial Accounting Standards No. 87 ("FAS  
4 87").<sup>6</sup>

5

6 **Q. Has FirstEnergy confirmed that the FAS 87 approach is used for the**  
7 **FirstEnergy utilities operating in West Virginia and Maryland?**

8 A. Yes. For example, FirstEnergy's response to OCA ME-XXI-7 indicates that the  
9 Maryland PSC and the West Virginia PSC have approved operating expense  
10 allowances for pension expense calculated for accounting purposes under FAS 87 for  
11 utilities subject to their jurisdiction, including FirstEnergy subsidiaries Potomac  
12 Edison Power Company and Monongahela Power Company.

13

14 **Q. Are you categorically opposed to using a cash funding approach for pension**  
15 **expense?**

16 A. No. A cash funding approach for pension expense appears to be used in a small  
17 minority of states. However, in my experience where the cash funding approach is  
18 used for pension expense, the use is based on contributions over a period much  
19 shorter than ten years. As an illustrative example, I participated in an electric and  
20 gas utility rate case in Washington State, where a four-year average of cash funding  
21 contributions was used as the basis for ratemaking recognition of pension expense.

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<sup>6</sup> This also appears to be confirmed from information in a current Oregon PUC docket that is generically addressing pension cost recovery in rates for all of the Oregon electric and gas utilities, Oregon PUC Case No. UM 1633.

1           The ten-year period recommended by FirstEnergy in the current rate cases  
2 appears to be an extreme position. In my experience, I am not aware of any other  
3 utility rate case other than the prior Met-Ed and Penelec cases in which an extremely  
4 long ten-year average was used for determining the utility allowance for pension  
5 expense. If an average of cash funding contributions were to be used in the current  
6 case, the average should be shorter than ten years.

7  
8 **Q. At page 22 of his rebuttal in the Met-Ed case, FirstEnergy witness D'Angelo**  
9 **addresses the recommendation of I&E witness Wilson to use an eight-year**  
10 **period for pension cash contributions which is apparently tied to her**  
11 **recommended use of an eight-year period for rate case expense normalization.**  
12 **Please comment.**

13 **A.** As noted above, the backward-looking ten-year historical period for pension funding  
14 contributions recommended by FirstEnergy in the current rate cases appears to be an  
15 extreme position. Using a shorter-historical period would be more reasonable and  
16 more consistent with regulatory treatment of pension cost in other jurisdictions that  
17 use cash funding contributions as the basis for utility pension expense. The eight-  
18 year period recommended by I&E also appears to be extremely long for the basis for  
19 ratemaking pension expense. A shorter average, such as three to five years, should  
20 be used if the cash funding method is going to be used as the basis for pension  
21 expense.

22  
23 **Q. Please summarize your recommendation concerning pension expense.**

1 A. As described in my direct testimony and above, I recommend that pension expense  
2 for ratemaking be based on the FAS 87 accrual amounts. Using a ten-year average  
3 of historical funding contributions is inconsistent with how the FE utilities budget  
4 for pension cost, whereas using the FAS 87 accrual amounts is consistent with FE's  
5 budgeting for pension cost. The FirstEnergy utilities' budgets for Pensions reflect the  
6 SFAS 87 accrual method. FirstEnergy also uses the accrual accounting for its actual  
7 Pension costs. The use of the FAS 87 amounts is consistent with GAAP and will  
8 produce reasonable cost recovery of pension expense in a fair manner and one which  
9 is consistent with how pension expense is recovered for other FirstEnergy utilities in  
10 states such as Maryland and West Virginia, and consistent with my understanding of  
11 the method most commonly used for utility pension expense in the majority of  
12 jurisdictions.

13  
14 **VI. OPEB EXPENSE**

15 **Q. What do the FirstEnergy Companies recommend in their rebuttal testimony**  
16 **concerning Other Post Employment Benefits ("OPEB") expense?**

17 A. They continue to request that recovery of OPEB expense focus only on the service  
18 cost component of OPEB costs per Statement of Financial Accounting Standards No.  
19 106 ("FAS 106"). At pages 31-33 of his Met-Ed rebuttal testimony (and similar  
20 rebuttal testimony in the other three FirstEnergy utility cases), Mr. D'Angelo  
21 mentions that in Met-Ed's and Penelec's last rate cases, the Commission used only  
22 the service cost component of FAS 106. He claims that the Company's budgets for  
23 OPEB cost and its GAAP accounting for OPEB costs should not be used because the

1 FAS 106 amounts include the effect of a number of factors. He also claims it would  
2 be unfair to switch methodologies.

3

4 **Q. Does basing the ratemaking recognition of OPEB costs on only the service cost**  
5 **component of FAS 106 match the benefit cost to the cost that is actually**  
6 **occurring during the test year?**

7 A. No, it does not. In fact, it does just the opposite. Use of the service cost component  
8 only, and not the full FAS 106 amount, will virtually assure that there is a mis-match  
9 between the ratemaking cost for the OPEBs and the cost that is actually occurring,  
10 which is based on the full FAS 106 amount that is recorded in accordance with  
11 GAAP. Focusing only on one component of FAS 106 -- the service cost component  
12 -- as FirstEnergy proposes here, is uncommon in utility regulation and is one-sided.  
13 Using only the service cost component, as proposed by FirstEnergy as a ratemaking  
14 methodology, is unfair and unbalanced because it only reflects one component which  
15 will virtually always have a positive cost.

16

17 **Q. Is it fair to use FAS 106 amount for ratemaking?**

18 A. Yes. FirstEnergy calculates and reports OPEB expense in accordance with FAS 106,  
19 which is consistent with GAAP. The recognition of OPEB expense using FAS 106  
20 in my experience is common in the utility industry. Using the same method for  
21 OPEB cost recognition (i.e., FAS 106) for ratemaking purposes that is used by  
22 FirstEnergy for accounting and budgeting purposes is fair and reasonable.

23

1 Q. Please respond to Mr. D'Angelo's claim (as stated in his Met-Ed rebuttal at  
2 page 33, line 9) that "to switch methodologies in this case would be patently  
3 unfair."

4 A. This does not apply to Penn Power or West Penn, as the use of this unusual method  
5 for recognizing OPEB costs for ratemaking was only approved for Met-Ed and  
6 Penelec in their last rate cases.

7 Moreover, as it applies to Met-Ed and Penelec (as well as to Penn Power and  
8 West Penn), as explained above, it is certainly fair to use the same method for  
9 ratemaking, FAS 106, that is used for accounting and budgeting purposes.

10 Furthermore, the failure to recognize the other components of FAS 106 cost  
11 and to focus only on the service cost component, misstates the accounting cost.

12 Additionally, the full adoption of FAS 106 as the ratemaking basis for  
13 recognizing utility OPEB expense appears to be anticipated by the Commission's  
14 statement of policy at 52 Pa. Code § 69.351 which addresses the Implementation of  
15 Statement of Financial Accounting Standards for Rule No. 106 (SFAS 106) for  
16 ratemaking purposes and indicates that: "The Commission intends to move  
17 jurisdictional utilities to SFAS 106 accrual accounting for ratemaking purposes  
18 within approximately 5 years and to allow the recovery in base rates of deferred  
19 amounts in approximately 20 years, to the extent that OPEB costs are prudently  
20 incurred and examined for reasonableness in a base rate proceeding prior to rate  
21 recognition."

22 SFAS 106 was adopted as part of GAAP in December 1990. As noted in §  
23 69.351, the Implementation of Statement of Financial Accounting Standards for Rule

1 No. 106 statement of policy states that: “Effective with financial statements for  
2 fiscal years beginning after December 15, 1992, SFAS 106 provides the generally  
3 accepted accounting principles to be used by large companies in accounting for post-  
4 retirement benefits other than pensions (OPEBs).” No one in the current case is  
5 disputing that FirstEnergy's OPEB costs as determined under FAS 106 are prudently  
6 incurred or that such OPEB costs are properly accounted for under FAS 106. The  
7 Commission has stated that it intends to move its jurisdictional utilities to SFAS 106  
8 accrual accounting for ratemaking purposes. The current FirstEnergy rate cases  
9 present a good opportunity for the Commission to fully implement the FAS 106  
10 accounting for ratemaking purposes for these FirstEnergy utilities.

11  
12 **Q. Please summarize your recommendation concerning the recognition of OPEB**  
13 **expense in the current FirstEnergy rate cases.**

14 **A.** As described in my direct testimony and above, and accordance with the  
15 Commission's statement of policy in § 69.351, FAS 106 accrual accounting should  
16 be used for the recognition of OPEB expense in the current rate cases. The use of  
17 full FAS 106 accrual accounting for OPEBs is consistent with how the FirstEnergy  
18 utilities budget for and account for their OPEB costs and is consistent with the  
19 guidance provided in the Commission's § 69.351 statement of policy, which stated  
20 that it intends to move its jurisdictional utilities to FAS 106 accrual accounting for  
21 ratemaking purposes.

1 **VI. PAYROLL EXPENSE**

2 **Q. Does FirstEnergy contest adjustments made by OCA (and I&E) for removing**  
3 **payroll increases and related benefits and payroll tax, for pay increases that**  
4 **FirstEnergy projects would occur beyond the end of the FPFTY?**

5 A. Yes. For example, FirstEnergy witness D'Angelo addresses this in his Met-Ed  
6 rebuttal at pages 27-31. He claims that removing such pay increases is inconsistent  
7 with longstanding Commission policy. He also disagrees with adjustments for  
8 payroll, benefits and payroll taxes that I had recommended to coordinate the amounts  
9 recognized within the FPFTY consistent with their occurrence during the FPFTY.

10  
11 **Q. Do you agree with Mr. D'Angelo's claim that excluding post-test year pay**  
12 **increases occurring during or beyond the end of a FPFTY is inconsistent with**  
13 **long-standing Commission policy?**

14 A. No. The Company's response to OCA discovery to Met-Ed (and the other utilities)  
15 such as OCA XXI-13 states that: "The Company is not aware of Commission orders  
16 that address the ratemaking treatment of pay increases that become effective during a  
17 FPFTY." If there was actually a long-standing Commission policy on pay increases  
18 that are projected to become effective during or beyond the end of a FPFTY, the  
19 Company should have been able to cite at least one Commission order. Since  
20 FirstEnergy has not been able to cite any Commission orders that address the  
21 ratemaking treatment of pay increases that become effective during or after a  
22 FPFTY, one can reasonably infer that the Company is not aware of any, and that  
23 there is, in fact, no long-standing Commission policy on pay increases that are  
24 projected to become effective during or beyond the end of a FPFTY.

1

2 **Q. Why should pay increases that are projected to occur after a FPFTY be**  
3 **excluded and pay increases that are projected to occur during a FPFTY be**  
4 **appropriately recognized only for the cost impacts that are projected to occur**  
5 **during the FPFTY?**

6 A. As described in my direct testimony and above<sup>7</sup> in this case a FPFTY is being used  
7 which corresponds to the first year of new rates. It is common in the utility industry  
8 in this context to reflect rate base and expense adjustments on an average test year  
9 basis. This is done in order to match the revenue requirement with the period  
10 covered by the first year of new rates. The situation where a FPFTY is being used to  
11 match the first year of new rates is conceptually different than historical ratemaking  
12 in Pennsylvania, where test years were used that ended prior to the effective date of  
13 new rates. In that traditional ratemaking, where test years were being used that were  
14 not fully forecasted, and where the test years did not match the rate effective period,  
15 it was common to utilize annualizations, so that the utility's revenue requirement  
16 would better match the cost of service during the first year of new rates.

17 With the use of a FPFTY, the projections extend into and cover the first year  
18 of new rates. Annualizations extending beyond the end of a FPFTY are not  
19 commonly used in this situation. For pay increases, the appropriate method to match  
20 the impact on the FPFTY cost of service is to reflect a pro ration of the amount of  
21 expense that will be incurred during the FPFTY. This properly matches the expense  
22 to be incurred in the FPFTY with the revenue requirement for the first year of new

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<sup>7</sup> See, e.g., Section II of my Surrebuttal Testimony, which addresses the application of the average test year concept in the context of a FPFTY, which corresponds to the first year of new rates.

1 rates. Going beyond that, as FirstEnergy proposes, will overstate the revenue  
2 requirement during the first year of new rates.

3

4 **Q. Please summarize your recommendations concerning pay increases, and the**  
5 **related impacts on benefits and payroll taxes.**

6 A. Pay increases that are projected to occur beyond the end of the FPFTY should be  
7 excluded from the revenue requirement for the FPFTY. Pay increases that are  
8 projected to occur during the FPFTY should be prorated according to when they are  
9 forecast to occur and the portion that falls within the FPFTY should be reflected, but  
10 the remainder that occurs in periods beyond the end of the FPFTY should be  
11 excluded. The related impacts on benefits and payroll taxes should be treated  
12 similarly. By including in the FPFTY the payroll and benefit costs that are forecast  
13 to occur during the FPFTY, the revenue requirement and the cost of service for the  
14 first year of new rates are appropriately coordinated. The related adjustments that  
15 were recommended in my direct testimony should be made in order to achieve this  
16 coordination.

17

## 18 **VII. VEGETATION MANAGEMENT**

19 **Q. What does FirstEnergy's rebuttal contend concerning Vegetation Management**  
20 **expense?**

21 A. FirstEnergy continues to recommend that its forecast level of expense be used. For  
22 example at pages 26-27 of his Met-Ed rebuttal, FirstEnergy witness D'Angelo argues  
23 against the use of an historic three-year average on the basis that FirstEnergy's claim

1 is based on the second year of a budget, and thus he states "it is not reasonable to  
2 expect knowledge of which particular trees would be trimmed that far in advance."<sup>8</sup>  
3 He also states that the Company is coming off an extensive corridor widening  
4 program that lasted several years, and thus anticipates a shift from capitalizing to  
5 expensing of Vegetation Management costs.<sup>9</sup> He claims that the three-year average  
6 would understate the amount of Vegetation Management activity expense in the  
7 FPPTY.<sup>10</sup>

8

9 **Q. Are you revising your recommended adjustment for Vegetation Management**  
10 **expense based on this FirstEnergy rebuttal?**

11 A. No. The amount projected by FirstEnergy for FPPTY Vegetation Management  
12 expense appears to be speculative. FirstEnergy apparently does not have specific  
13 information on basic matters such as which routes are projected to be trimmed  
14 during the FPPTY. Additionally, Mr. D'Angelo's rebuttal testimony is rather vague  
15 concerning his reference to numerous requests seeking detailed information about  
16 FirstEnergy's forecasted Vegetation Management expenses. His rebuttal does not  
17 cite a single response. Additional discovery, including OCA Set XXI, asking about  
18 Vegetation Management expenses in reference to Mr. D'Angelo's rebuttal testimony,  
19 has not been answered as of January 4, 2015.

20

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<sup>8</sup> See, e.g., Met-Ed Rebuttal (Statement 2R) at page 26, lines 15-17.

<sup>9</sup> Id., at page 27.

<sup>10</sup> Id.

1 **VIII. CASH WORKING CAPITAL**

2 **Q. Will you be responding to some of the Cash Working Capital related issues that**  
3 **are addressed in FirstEnergy witness Patricia Larkin's rebuttal testimony?**

4 A. Yes. I will respond to some of the Cash Working Capital related issues that are  
5 addressed in FirstEnergy witness Patricia Larkin's rebuttal testimony in this section  
6 of my Surrebuttal Testimony.

7  
8 **Q. Do you agree that the CWC method used by Ms. Larkin is an appropriate**  
9 **method for determining CWC in the current FirstEnergy rate cases?**

10 A. No. Substantial aspects of the CWC method used by Ms. Larkin for determining  
11 CWC in the current FirstEnergy rate cases were specifically addressed and rejected  
12 in the most recent Met-Ed and Penelec rate cases, as described in my direct  
13 testimony. These aspects include FirstEnergy's attempt to include non-cash  
14 expenses in the CWC and FirstEnergy's failure to recognize the lag associated with  
15 cash expenses for interest payments. At page 6, lines 9-12, for example, of her Met-  
16 Ed rebuttal testimony, Ms. Larkin states that: "The Company acknowledges the  
17 Commission has not historically approved the inclusion of operating income in CWC  
18 requirements, and I agree that Mr. Smith's methodology follows that approach." The  
19 Companies attempted to use a similar methodology in the most recent Met-Ed and  
20 Penelec rate cases and it was specifically rejected by the Commission, as described  
21 in my direct testimony. It should likewise be rejected in the current FirstEnergy rate  
22 cases for the reasons described in my direct testimony and herein.

1 **Q. At page 7 of her Met-Ed rebuttal testimony, FirstEnergy witness Larkin claims**  
2 **that inclusion of an Unamortized Cash Pension Contribution in CWC "is based**  
3 **on the long-standing Commission precedent of including prepaid expenses."<sup>11</sup>**  
4 **Please respond.**

5 A. As described in my direct testimony, no amount for Unamortized Cash Pension  
6 Contributions was included in the Met-Ed or Penelec claim for CWC in Docket Nos.  
7 R-00061366 and R-00061367, and the amounts of prepaid expenses allowed in  
8 CWC in those cases were substantially lower and did not include any amounts for  
9 Unamortized Cash Pension Contributions. The attempt by FirstEnergy to include  
10 Unamortized Cash Pension Contributions in CWC in the current rate cases is not  
11 authorized in any prior Commission orders that the Company has been able to  
12 identify. Contrary to the Companies' claims, there is in fact no Commission  
13 precedent that they have cited, much less a long-standing Commission precedent, for  
14 including amounts for Unamortized Cash Pension Contributions in rate base as CWC  
15 or prepayments.

16 I have reviewed the Order in the prior Met-Ed and Penelec rate case  
17 proceeding as well as the Met-Ed and Penelec CWC filings and the OCA's testimony  
18 on CWC in those dockets and find no inclusion in CWC of any line item for  
19 Unamortized Cash Pension Contributions. Additionally, the amount of CWC that  
20 FirstEnergy is claiming for Unamortized Cash Pension Contributions is grossly  
21 disproportionate with the prepaid amounts that were included in the last Met-Ed and  
22 Penelec rate cases.

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<sup>11</sup> See, e.g., Met-Ed Statement No. 6-R, page 7, lines 3-14. Similar rebuttal was presented by FirstEnergy witness Larkin concerning the other utilities.

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**Q. What amount of prepayments was requested by Met-Ed and Penelec in Docket Nos. R-00061366 and R-00061367?**

A. According to Met-Ed Exhibit MJS-1, pages 1 and 14 of 14 in Docket Nos. R-00061366, the total prepayments balance claimed by Met-Ed in that case was \$916,000. Moreover, the items included are Prepaid PaPUC Assessments, Prepaid Property & Liability Insurance and Prepaid EEI dues. There is no inclusion of any Unamortized Cash Pension Contributions.

Similarly, according to Met-Ed Exhibit MJS-1, pages 1 and 14 of 14 in Docket No. R-00061367, the total prepayments balance claimed by Penelec in that case was \$932,000. Moreover, the items included are PaPUC Assessments, Prepaid Property & Liability Insurance and Prepaid EEI dues. There is no inclusion of any Unamortized Cash Pension Contributions.

In contrast, the amounts claimed for prepayments by FirstEnergy in the current rate cases are grossly disproportionate to the prepaid amounts from the prior Met-Ed and Penelec rate cases. The prepayment amounts would be comparable only with the exclusion of the FirstEnergy requested amounts for Unamortized Cash Pension Contributions in the current rate cases.

**Q. Are there statements in the Companies' testimony in the current rate cases indicating that their attempted inclusion of Unamortized Cash Pension Contributions is a new item that has not previously been authorized for rate base inclusion in any prior rate case by the Commission?**

1 A. Yes. As described in my direct testimony, for example, the direct testimony of Ms.  
2 Larkin at Companies' Statement 6, page 14, lines 4-7, singles out their attempted  
3 inclusion of Unamortized Cash Pension Contributions as an exception to the  
4 methodology that Met-Ed and Penelec employed in their 2006 base rate cases in  
5 Docket Nos. R-00061366 and R-00061367.

6

7 **Q. What adjustments are needed to remove the Unamortized Cash Pension**  
8 **Contributions from FirstEnergy's CWC requests in the current rate cases?**

9 A. The amounts FirstEnergy is claiming Unamortized Cash Pension Contributions are  
10 listed below (and shown on Schedule B-4, page 1, line 26, of the revenue  
11 requirement exhibits filed with my direct testimony for each of the four FirstEnergy  
12 utilities):

- 13 • \$30.177 million for Met-Ed
- 14 • \$17.912 million for Penelec
- 15 • \$5.125 million for Penn Power, and
- 16 • \$28.383 million for West Penn.

17

18 These amounts should be removed from CWC in the current rate cases for the  
19 reasons described in my direct testimony and above.

20

21 **Q. Has FirstEnergy witness Larkin attempted to substantially increase CWC**  
22 **based on using a different period for the revenue lag for the first time in**  
23 **rebuttal?**

1 A. Yes. For example, in her Met-Ed rebuttal at pages 3-4, Ms. Larkin discusses a  
2 recommendation by I&E witness Wilson to use a monthly rather than a quarterly  
3 average of accounts receivable to average billed revenue in order to derive the  
4 accounts receivable turnover ratio. Ms. Larkin indicates that she agrees with that  
5 recommendation of I&E witness Wilson. I&E witness Wilson's recommendation  
6 was based on the 12-months ending March 31, 2014, which corresponds to the  
7 historic test year used in FirstEnergy's applications, and corresponds with the period  
8 used for most of the expense lags in the FirstEnergy lead-lag studies. However, on  
9 pages 4 and 9 of her rebuttal, Ms. Larkin then attempts to update the period used for  
10 the revenue lag to the 12-months ending November 30, 2014. On page 9 she  
11 indicates that FirstEnergy is now requesting revised amounts of CWC that are based  
12 on using a higher overall revenue lag.

13

14 **Q. Do you object to using the monthly average of accounts receivable to monthly**  
15 **average billed revenues to determine the accounts receivable turnover ratio, as**  
16 **recommended by I&E witness Wilson?**

17 A. No. The use of monthly average of accounts receivable to monthly average billed  
18 revenues to determine the accounts receivable turnover ratio, as recommended by  
19 I&E witness Wilson appears to be reasonable and consistent with how the lag was  
20 determined in the prior Met-Ed and Penelec rate cases. However, merely changing  
21 from quarterly to monthly accounts receivable balances should not result in  
22 switching the entire period used to measure the revenue lag.

23

1 **Q. Do you agree with FirstEnergy's attempt to revise the revenue lag to use a**  
2 **different period through November 2014?**

3 A. No. The lead-lag study is based on analyzing expenses using historical expense  
4 payment lags using information for the 12 months ending March 2014. I&E witness  
5 Wilson's recommendation to use monthly accounts receivable information is also  
6 based on the 12 months ending March 2014. The FirstEnergy filings were based on  
7 a revenue lag using quarterly accounts receivable information and monthly revenues  
8 for the 12 months ending March 2014. The change proposed for the first time in  
9 rebuttal testimony by FirstEnergy to extend the period used to measure the revenue  
10 lag to November 2014 creates a mis-matching of the revenue lag with the other  
11 components of the lead-lag study, and does so in a manner that raises concerns about  
12 abnormal weather events in 2014, such as the polar vortex, which could have  
13 presented higher bills and payment issues for customers, thus leading to an abnormal  
14 weather related issue for collections and revenue lag. This attempt by FirstEnergy to  
15 increase its CWC for a piecemeal update of the revenue lag through November 2014  
16 creates inconsistencies within the lead-lag study and is one-sided because expense  
17 lags are not updated through the same period. This FirstEnergy update attempt  
18 should be rejected for the reasons described herein.

19

20 **Q. Is there also a concern that the revenue and accounts receivable information for**  
21 **at least part of 2014 is abnormal and not representative of ongoing conditions?**

22 A. Yes. The first part of 2014 was impacted by the polar vortex, which was an unusual  
23 weather event. The use of revenues and accounts receivable balances for 2014 thus

1 also raise the concern about being impacted by the polar vortex and thus not being  
2 representative of normal, ongoing conditions.

3

4 **Q. Please summarize your recommendation concerning the period to be used for**  
5 **the revenue lag.**

6 A. As described in my direct testimony, I calculated the revenue lag based on calendar  
7 2013 information. This was done to exclude impacts from the abnormal weather  
8 associated with the extreme cold from the polar vortex that occurred during the first  
9 quarter of 2014. I do not object to the recommendations of I&E witness Wilson to  
10 use monthly accounts receivable balances (rather than the quarterly balances used by  
11 FirstEnergy for the collection lag in its original filings) to determine the revenue lag  
12 for CWC purposes. I recommend that, if monthly accounts receivable information is  
13 to be used, it should be applied for 2013, rather than for the 12 months ending March  
14 2014, and certainly not based on shifting the period for measuring this lag from the  
15 March 2014 period used for the FirstEnergy lead-lag study to another subsequent  
16 period such as through November 2014 that presents heightened concerns about  
17 unusually high bills and payment difficulties and results that are distorted from  
18 abnormal weather events. There are concerns about the use of revenue and accounts  
19 receivable information through November 2014, especially one which presents  
20 concerns about impacts from abnormal weather such as the polar vortex. The use of  
21 revenue lag information through November 2014 also creates additional  
22 inconsistencies between the period used in the lead-lag study to measure expense  
23 and revenue lags.

1

2 **Q. What impact is produced by using monthly accounts receivable information**  
3 **rather than quarterly?**

4 A. Using monthly balances for the accounts receivable as recommended by I&E witness  
5 Wilson in comparison with FirstEnergy's calculations, indicates that changing from  
6 quarterly to monthly balances for accounts receivable should produce a modest  
7 decrease in the revenue lags originally proposed by FirstEnergy in its applications, as  
8 summarized in the following tables, which compare the collection lags (1) originally  
9 proposed by FirstEnergy in its applications, (2) as adjusted by I&E witness Wilson  
10 to reflect monthly rather than quarterly accounts receivable balances,<sup>12</sup> and (3) as  
11 now proposed by FirstEnergy in Ms. Larkin's rebuttal Exhibit PML-2, page 3:

<b>Met-Ed Collection Days Lag</b>	<b>Met-Ed Exhibit</b>	<b>I&amp;E Exhibit No. 2</b>	<b>Met-Ed Exhibit</b>
<b>Description</b>	<b>PML-1</b>	<b>Sch. 18</b>	<b>PML-2</b>
Collection Days Lag	48.5	45.5	56.9
Difference		-3	8.4

12

<b>Penelec Collection Days Lag</b>	<b>Penelec Exhibit</b>	<b>I&amp;E Exhibit No. 2</b>	<b>Penelec Exhibit</b>
<b>Description</b>	<b>PML-1</b>	<b>Sch. 18</b>	<b>PML-2</b>
Collection Days Lag	45.1	42.6	54.2
Difference		-2.5	9.1

13

<b>Penn Power Collection Days Lag</b>	<b>Penn Power Exhibit</b>	<b>I&amp;E Exhibit No. 2</b>	<b>Penn Power Exhibit</b>
<b>Description</b>	<b>PML-1</b>	<b>Sch. 18</b>	<b>PML-2</b>
Collection Days Lag	39.4	36.6	43.3
Difference		-2.8	3.9

14

<b>West Penn Collection Days Lag</b>	<b>West Penn Exhibit</b>	<b>I&amp;E Exhibit No. 2</b>	<b>West Penn Exhibit</b>
<b>Description</b>	<b>PML-1</b>	<b>Sch. 18</b>	<b>PML-2</b>
Collection Days Lag	40.2	38.1	48.4
Difference		-2.1	8.2

15

<sup>12</sup> See, e.g., I&E Exhibit 2, Schedule 18.

1

2 **Q. Do you have any other comments on the revenue lag?**

3 A. Yes. Conceptually, a modest decrease in the revenue collection lag, such as  
4 reflected in the I&E adjustment, would be expected with an improving economy,  
5 other things being equal.

6

7 **IX. CONSOLIDATED TAX SAVINGS**

8 **Q. Does FirstEnergy agree with the Consolidated Tax Savings (CTA) adjustment?**

9 A. No. FirstEnergy witness D'Angelo addresses this at pages 36-39 of his Met-Ed  
10 rebuttal testimony (and similarly in his rebuttal testimony for Penelec and Penn  
11 Power). At page 37 of his Met-Ed rebuttal, he suggests that a five-year historic  
12 average of 2009-2013 should be used, rather than a three year average. He claims  
13 further that a CTA should not be made because an industry restructuring has  
14 occurred after the passage of the Competition Act.

15

16 **Q. Should a CTA be made in the current FirstEnergy rate cases?**

17 A. Yes. The industry restructuring has occurred after the passage of the Competition  
18 Act and does not affect the benefits that are derived from participation in a  
19 consolidated federal income tax return. A CTA should be made to reflect the  
20 participation in the consolidated federal income tax return. Additionally, as noted in  
21 my direct testimony, I am advised by Counsel that in Pennsylvania a CTA is  
22 required by Pennsylvania law.

23

1 **Q. At page 37 of his Met-Ed rebuttal testimony, FirstEnergy witness D'Angelo**  
2 **states that 100% bonus depreciation applied in 2011 and therefore 2011 should**  
3 **be considered an "outlier" and he recommends a five-year period of 2009-2013**  
4 **be used for the CTA. Please respond.**

5 A. For computing the CTA, as shown in the exhibits attached to my direct testimony, I  
6 used a three-year average of 2011 through 2013. This average was used because it  
7 reflects the most recent period for which FirstEnergy consolidated federal income  
8 tax information is available, and is a period that is after the FirstEnergy/Allegheny  
9 merger. Tax results for years prior to the FirstEnergy/Allegheny were excluded as  
10 not being representative of the current or going forward FirstEnergy consolidated  
11 income tax return.

12  
13 **Q. Do you agree with Mr. D'Angelo that 2011 is abnormal for the FirstEnergy**  
14 **consolidated tax return, and what would be the impact of excluding 2011 from**  
15 **your calculation of the CTA?**

16 A. No, I do not agree with Mr. D'Angelo that 2011 is abnormal with respect to the  
17 FirstEnergy consolidated income tax returns, and have therefore not excluded it.

18 If 2011 were to be excluded and the CTA for these FirstEnergy utilities were  
19 based on an average of 2012 and 2013, the total CTA for Met-Ed, Penelec and Penn  
20 Power would be approximately \$32.5 million (as opposed to the approximately  
21 \$23.9 million combined CTA that was reflected in my direct testimony and exhibits  
22 in the Met-Ed, Penelec and Penn Power rate cases). The CTA amounts for each of

1 the utilities using an average of 2012 and 2013 FirstEnergy consolidated tax return  
2 results would be:

- 3 • \$21.548 million for Met-Ed
- 4 • \$5.516 million for Penelec, and
- 5 • \$5.444 million for Penn Power.<sup>13</sup>

6

7 **Q. Have you attached an Exhibit showing the related calculations of the CTA that**  
8 **would result if a two year average of the 2012 and 2013 FirstEnergy**  
9 **consolidated tax return information were used?**

10 A. Yes. Exhibit LA-4, which reflects a recalculation of the CTA using FirstEnergy  
11 consolidated tax information for 2012 and 2013, is attached to my surrebuttal  
12 testimony. This recalculation uses the same format as the CTA adjustment shown on  
13 Schedule C-1, page 1 of 3, of the revenue requirement exhibits that were filed with  
14 my direct testimony.

15

16 **X. FEDERAL 2014 TAX EXTENDERS**

17 **Q. Was a significant federal "tax extender" bill signed into law shortly after the**  
18 **FirstEnergy rebuttal testimony in this case was filed?**

19 A. Yes. The rebuttal testimony was filed on December 18, 2014. On December 19,  
20 2014, President Obama signed into law federal legislation for 2014 "tax extenders"  
21 which basically extended through 2014 a number of important tax deductions,  
22 including bonus depreciation.

23

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<sup>13</sup> As noted in my direct testimony, there is no CTA for West Penn because West Penn did not have positive taxable income in the years utilized for the CTA.

1 **Q. What do you recommend?**

2 A. The impacts of the 2014 federal "tax extender" on the FPFTY for each of the four  
3 FirstEnergy utilities should be reflected. This is primarily expected to result in  
4 reduced FPFTY rate base that results from increased accumulated deferred income  
5 taxes from the 2014 bonus tax depreciation. Discovery in OCA set XXI was asked  
6 of FirstEnergy in order to obtain quantifications of the impacts.

7

8 **Q. Does this conclude your surrebuttal testimony?**

9 A. Yes, it does. I note that responses to a number of requests in OCA Set XXI, which  
10 was asked about FirstEnergy's rebuttal testimony, were not received by OCA or me  
11 in time for incorporating such responses into this surrebuttal testimony. I would  
12 therefore reserve the right to update my testimony, if necessary, on the subject matter  
13 of those OCA Set XXI interrogatories, at the hearings.

14 200106

# EXHIBIT

**REDACTED**

Fully Projected Future Test Year Ended 4/30/2016  
 (Thousands of Dollars)

Line No.	Description	Met-Ed Amount (A)	Penelec Amount (B)	Penn Power Amount (C)	West Penn Amount (D)	Total Amount (E)
1	Consolidated Tax Savings Adjustment Using 2012 and 2013	\$ (21,548)	\$ (5,516)	\$ (5,444)	\$ -	\$ (32,508)

**Notes and Source**

Col. A: Adjustment calculated using data from the response to OCA ME Set 1, No. 226, Confidential Attachment A and calculated as follows:

	2011	2012	2013	3-Year Average	Reference	2-Year Avg. 2012-2013
2	Total Taxable Losses Excluding Regulated Companies				Page 2	
3	Total Taxable Incomes				Page 3	
<b>Taxable Income of Pennsylvania Utilities</b>						
4	Met-Ed Taxable Income	2011	2012	2013	3-Year Average	
5	Penelec Taxable Income					OCA Set 1, No. 226
6	Penn Power Taxable Income					OCA Set 1, No. 226
7	West Penn Taxable Income					OCA Set 1, No. 226
8	Total Taxable Income of Pennsylvania Utilities	\$ -	\$ -	\$ -	\$ -	\$ -
9	Percentage of PA Utilities Taxable Income to Total Taxable Income					L8 / L3
10	Adjustment for Consolidated Tax Savings Applicable to PA Utilities					
11	Adjustment to Federal Income Taxes @ 35%				\$ -	L2 x L9
12	Met-Ed Allocation of PA Utility Income				\$ -	L10 x 35%
13	Met-Ed Consolidated Tax Adjustment				\$ -	L4 / L8
14	Penelec Allocation of PA Utility Income					
15	Penelec Consolidated Tax Adjustment				\$ -	L5 / L8
16	Penn Power Allocation of PA Utility Income					
17	Penn Power Consolidated Tax Adjustment				\$ -	L6 / L8
18	Total, Met-Ed, Penelec and Penn Power					


BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :  
v. :  
Pennsylvania Electric Company : Docket No. R-2014-2428743

VERIFICATION

I, Ralph C. Smith hereby state that the facts above set forth in my Surrebuttal Testimony, OCA Statement No. 1SR is true and correct and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa.C.S. § 4904 (relating to unsworn falsification to authorities).

Signature:

  
Ralph C. Smith

Consultant Address: Larkin & Associates, PLLC  
15728 Farmington Road  
Livonia, MI 48154

DATED: January 6, 2015

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