**PENNSYLVANIA**

 **PUBLIC UTILITY COMMISSION**

####  Harrisburg, PA 17105-3265

Public Meeting held December 2, 2004

Commissioners Present:

 Wendell F. Holland Chairman

 Robert K. Bloom, Vice Chairman, Partial Dissenting Statement attached

 Glen R Thomas

 Kim Pizzingrilli

Pennsylvania Public Utility Commission : R-00049255

U.S. Department of Defense & Federal :

 Executive Agencies : R-00049255C0001

PPL Industrial Customer Alliance : R-00049255C0002

Office of Small Business Advocate : R-00049255C0003

Office of Consumer Advocate : R-00049255C0004

Anthony J. Graziano : R-00049255C0005

Brenda Hoover : R-00049255C0006

Eric Joseph Epstein : R-00049255C0007

Victoria K. Mackin, et al. : R-00049255C0008

Cheryl & Jeremy Ebert : R-00049255C0009

Martha Wells : R-00049255C0010

Margaret M. Stuski : R-00049255C0011

Wal-Mart Store East, LP. : R-00049255C0012

Pennsylvania Energy Consortium : R-00049255C0013

Donald F. McGarrigle : R-00049255C0014

Curvin L. Snyder : R-00049255C0015

William J. Junkin, III : R-00049255C0016

Philip A. Trump : R-00049255C0017

Pennsylvania Retailers Association : R-00049255C0018

Christy Meyers : R-00049255C0019

Steven P. Carlyle : R-00049255C0020

 v.

PPL Electric Utilities Corporation

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**OPINION AND ORDER**

**BY THE COMMISSION:**

Before the Commission are the Recommended Decision of Administrative Law Judge (ALJ) Allison K. Turner issued October 22, 2004, and the Exceptions filed thereto. Citizens for Pennsylvania’s Future (PennFuture) filed its Exceptions on November 10, 2004. Exceptions were filed on November 12, 2004, by Commercial Customer Consortium (CCC), Commission on Economic Opportunity (CEO), Eric Joseph Epstein (Mr. Epstein), Office of Consumer Advocate (OCA), Office of Small Business Advocate (OSBA), Office of Trial Staff (OTS), PPL Electric Utilities Corporation (PPL), PPL Industrial Customer Alliance (PPLICA), PPL Public Lighting User Group (PLUG), and Sustainable Energy Fund of Central Eastern Pennsylvania (SEF). Replies to Exceptions were filed by the OCA, OSBA, OTS, CCC, SEF, PPLICA, PennFuture, PLUG, and PPL on November 22, 2004.

**I. HISTORY OF THE CASE**

On March 29, 2004, PPL filed Supplement No. 38 to Tariff Electric-Pa. P.U.C. No. 201 to become effective June 1, 2004, seeking Commission approval to increase its retail distribution base rate revenues by $164.4 million.[[1]](#footnote-1) The Company’s request was based on a future test year ending December 31, 2004. Additionally, PPL sought to increase transmission charges by approximately $57.2 million.[[2]](#footnote-2)

The following entities and individuals filed Formal Complaints against the rate increase and were assigned docket numbers accordingly: United States Department of Defense & Federal Executive Agencies (USDOD), R-00049255C0001; PPLICA, R-00049255C0002; OSBA, R-00049255C0003; OCA, R-00049255C0004; Anthony J. Graziano, R-00049255C0005; Brenda Hoover, R-00049255C0006; Mr. Epstein, R-00049255C0007; Victoria Mackin, R-00049255C0008; Cheryl & Jeremy Ebert, R-00049255C0009; Martha Wells, R-00049255C0010; Margaret Stuski, R-00049255C0011; WAL-MART Store East, LP, R-00049255C0012; Pennsylvania Energy Consortium, R-00049255C0013; Donald McGarrigle, R-00049255C0014; Curvin Snyder, R-00049255C0015; William J Junkin, III, R-00049255C0016; Philip A. Trump, R-00049255C0017; Pennsylvania Retailers Association, R-00049255C0018; Christy Meyers, R-00049255C0019; and Steven P. Carlyle, R-00049255C0020. The OTS entered its Notice of Appearance on April 22, 2004. Approximately 100 of PPL’s customers filed individual Complaints, and rate Protests which were placed in the Public Comment file. PPL answered all of the Complaints and moved to dismiss only one Complainant, Margaret Stuski (C0011).

The following entities filed Petitions to Intervene which were granted: the International Brotherhood of Electrical Workers, Local 1600 (IBEW); CEO; PECO Energy Company (PECO); West Penn Power Company d/b/a Allegheny Power (Allegheny); the Clean Air Council (CAC); SEF; the Mid Atlantic Power Supply Association (MAPSA); Strategic Energy Limited, L.L.C. (Strategic); the United States Department of Defense (USDOD); UGI Utilities, Inc. (UGI); PLUG; and PennFuture. PPL responded to each of these Petitions, but did not oppose the participation of any of the Petitioners. The following Intervenors did not actively participate and were dismissed by the ALJ: PECO; Allegheny; UGI; and IBEW.

The following entities filed Petitions to Intervene that were denied for lack of standing: Duquesne Light Company; Sustainable Development Fund (SDF); Metropolitan Edison Company; Pennsylvania Electric Company; and American Transmission Systems.

PPL is currently operating under a transmission and distribution rate cap and is prohibited from raising its distribution rates before December 31, 2004. By Order entered May 7, 2004, the Commission directed that an investigation be instituted to determine the fairness, reasonableness and justness of rates named in Supplement No. 38 to Tariff Electric-Pa. P.U.C. No. 201. The Commission further directed that, pursuant to Section 1308(d) of the Pennsylvania Public Utility Code (Code), 66 Pa. C.S. § 1308(d), the filing be suspended by operation of law on June 1, 2004, until January 1, 2005, and that PPL could not increase distribution rates before the end of 2004 due to the transmission and distribution rate cap. The case was then assigned to the Office of Administrative Law Judge (OALJ) for the scheduling of hearings to culminate in the issuance of a Recommended Decision.

On May 10, 2004, the OALJ served a notice scheduling an Initial Prehearing Conference to be held in Harrisburg on May 19, 2004, at 2:00 p.m. The case was assigned to ALJ Turner for preliminary rulings, hearing and decision, and to ALJs Susan Colwell and Ember Jandebeur for hearings. On May 12, 2004, ALJ Turner served her first Prehearing Order, establishing certain basic procedures to be followed before and during the Initial Prehearing Conference.

The following Parties participated in the Initial Prehearing Conference before ALJ Turner: PPL; OTS; OCA; OSBA; PPLICA; USDOD; IBEW; Mr. Epstein; CEO; SEF; PennFuture; MAPSA; CAC; PLUG; Allegheny; Duquesne Light Company (Duquesne); PECO; and UGI.

The ALJ issued a second Prehearing Order establishing a procedural schedule and rules to be followed during the proceeding. Following the Prehearing Conference, the Parties held an informal discovery conference at PPL in Allentown, and participated in several settlement conferences and discussions. However, no agreements were reached.

A total of nine Public Input Hearings (PI Hearings) were held throughout PPL’s service territory. ALJ Colwell conducted the PI Hearings in Lancaster and Harrisburg. ALJ Jandebeur conducted the PI Hearings in Scranton and Wilkes-Barre.

Four days of Evidentiary Hearings were held in Harrisburg the week of August 9, 2004. During that time, testimony and exhibits of all the active Parties were entered into the record. A total of 1,135 pages of transcript were produced (including the PI Hearings), and the record closed on August 13, 2004.

The following Parties filed Main Briefs on September 2, 2004: PPL; OTS; OCA; OSBA; USDOD; PPLICA; PennFuture; CAC; SEF; Eric Epstein; and CEO. The following Parties submitted Reply Briefs on September 13, 2004: PPL; OTS; OCA; OSBA; PPLICA; PennFuture; CAC; SEF; and CEO.

By Initial Decision issued September 13, 2004, ALJ Turner granted PPL’s Motion to Dismiss Ms. Stuski’s Complaint at C0011. On September 15, 2004, Christy Meyers filed a Formal Complaint against the rate increase at Docket Number R‑00049255C0019. On September 23, 2004, PPL filed its Answer to the Complaint. On October 22, 2004, Steven P. Carlyle filed a Formal Complaint against the rate increase at Docket Number R-00049255C0020.

ALJ Turner’s Recommended Decision, which was served on the Parties on October 22, 2004, and modified by the Errata issued October 25, 2004, *inter alia*, granted PPL a rate increase of $130,111,983, and set a Transmission Service Charge (TSC) rate of $0.05439 per kWh.

1. **OVERVIEW**

**A. Statutory Framework**

Before proceeding to a discussion of PPL’s proposed rate increase, it is necessary to review the statutory considerations that will guide us as we review the Parties’ arguments in this proceeding. Section 315(a) of the Code, provides that:

Reasonableness of rates. -- In any proceeding upon the motion of the commission, involving any proposed or existing rate of any public utility, or in any proceedings upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. § 315(a). Section 1301 of the Code, provides that:

Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission. Only public utility service being furnished or rendered by a municipal corporation, or by the operating agencies of any municipal corporation, beyond its corporate limits, shall be subject to regulation and control by the commission as to rates, with the same force, and in like manner, as if such service were rendered by a public utility.

66 Pa. C.S. § 1301.

The burden of proof in a rate proceeding is squarely upon the utility to establish that the rate is just and reasonable under 66 Pa. C.S. § 1301. *Pennsylvania Power Co. v. Pennsylvania Public Utility Commission*, 625 A.2d 719, 723 (Pa. Cmwlth. Ct. 1993); *Lower Frederick Township Water Company v. Pennsylvania Public Utility Commission*, 409 A.2d 505, 507 (Pa. Cmwlth. Ct. 1980). Section 332(a) of the Code, 66 Pa. C.S. § 332(a), provides that the party seeking a rule or order from the Commission has the burden of proof in that proceeding. It is axiomatic that “[a] litigant’s burden of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of evidence which is substantial and legally credible.” *Samuel J. Lansberry, Inc. v. Pennsylvania Public Utility Commission*, 578 A.2d 600, 602, (Pa. Cmwlth. Ct. 1990).

With specific reference to base rate proceedings, it is well settled at the Commission and in the courts that the utility’s burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one that remains with the public utility throughout the course of the proceeding. While the burden of going forward may shift, the burden of finally and convincingly establishing the justness of the requested rate increase remains on the utility. This burden does not shift to intervenors challenging a requested rate increase. *Pennsylvania Public Utility Commission, et al. v. Lemont Water Co.*, Docket Nos. R-00932673, 1993 Pa. PUC LEXIS 197 \*14 (November 29, 1993); *Berner v. Pennsylvania Public Utility Commission*, 382 Pa. 622, 116 A.2d 738 (1955).

Also, the Pennsylvania Courts and our previous rate determinations require that PPL demonstrate by substantial evidence that its overall rates be increased. Moreover, as to individual expense items, PPL bears the burden of proving that the expense item is prudently incurred and reasonable in amount. *Pennsylvania Public Utility Commission v. Philadelphia Gas Works*, R-00006042, *et al.* and C-00014826, *et al.,* 2001 Pa. PUC LEXIS 103, \*29 (October 4, 2001).

Initially, we note that we have carefully considered the issues, concerns, and arguments of the Parties, contained in the transcripts, Briefs, Exceptions, and Reply Exceptions. Any Exception that we do not specifically address herein has been duly considered and will be denied without further discussion. It is well settled that we are not required to consider expressly or at length each contention or argument raised by the parties. *Wheeling & Lake Erie Railway Co. v. Pennsylvania Public Utility Commission*, 778 A.2d 785, 794 (Pa. Cmwlth. Ct. 2001); [University of Pennsylvania v. Pennsylvania Public Utility Commission, 485 A.2d 1217 (Pa. Cmwlth. Ct. 1984).](file://C:\research\buttonTFLink?_m=69761b6202cb4178e2a6e6fe02f5751b&_xfercite=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b2000%20Pa.%20PUC%20LEXIS%2067%20%5d%5d%3e%3c\cite%3e&_butType=3&_butStat=242&_butNum=6&_butInline=1&_butinfo=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b485%20A.2d%201217%5d%5d%3e%3c\cite%3e&_fmtstr=FULL&docnum=5&_startdoc=1&_startchk=1&wchp=dGLSzS-lSlbz&_md5=9b1cc8319afd12440738bb82d74455ef)

1. **Summary of Result**

As will be further delineated herein, based upon our review and consideration of the evidentiary record as developed in this proceeding, including the Recommended Decision of ALJ Turner and the Exceptions of the Parties and Replies filed with respect thereto, we conclude that PPL is entitled to an opportunity to earn income available for a return of $154,855,965 on the portion of its rate base applicable to distribution. In furtherance of such objective, PPL is authorized to establish rates that will produce not in excess of $661,385,219 in jurisdictional operating distribution revenues. The increase in annual operating distribution revenues authorized herein of $137,101,767 is approximately 85.99% of the $159,443,000 (adjusted from the original $164.4 million) originally sought and an increase of approximately 7.13 % to total revenues generated through current rates.

**III. DESCRIPTION OF THE COMPANY**

PPL presently serves approximately 1.3 million customers throughout a 10,000 square mile territory in twenty-nine Pennsylvania counties. (PPL Exh. Future 1 (Rev) at 4).

PP&L was founded in 1920, as a direct subsidiary of Lehigh Power Securities Corporation and an indirect subsidiary of Electric Bond and Share Company (Electric Bond). Various mergers followed throughout the years and in 2000, PP&L, Inc. became PPL Electric Utilities Corporation (PPL) and the name of the holding company became PPL Corporation (PPL Corp.). (R.D. at 9-10).

On July 1, 2000, PPL Corp. and PPL completed a corporate realignment in order to effectively separate PPL’s regulated transmission and distribution operations from its deregulated generation operations. In 2001, PPL Corp. completed a strategic initiative to confirm the structural separation of PPL from PPL Corp. and the other affiliated companies. (R.D. at 10).

PPL is now a “wires only” company. Under the new corporate structure, PPL Services Corporation provides various administrative and general services to PPL and other subsidiaries of PPL Corp. Another sister subsidiary, PPL Solutions, LLC provides energy supplier coordination services to PPL. These services include communications, energy load scheduling, and reconciliation services. PPL also has a long-term wholesale “full requirements” supply contract at fixed prices with its corporate affiliate, PPL Energy Plus through the remainder of this decade. (R.D. at 11).

We now consider the issues presented in the Recommended Decision and the Exceptions filed by the Parties.

**IV. RATE BASE**

PPL initially proposed a Pennsylvania jurisdictional rate base as of December 31, 2004, of $1,842,744,000. (PPL Exh. Future 1, Sched. C-1). Subsequent to the filing of the case, PPL accepted the following adjustments to rate base:

(1) Elimination of the amortization of Power Management System (“PMS”) software (PPLEU Ex. Future 1 (Revised), Sch. C-2, p. 2), which now has been accepted by the OCA (Tr.

 489-490);

(2) Adjustments to post retirement benefits, pension and the Supplemental Executive Retirement Plan (“SERP”) (PPLEU Ex. Future 1 (Revised), Sch. C-2a, p. 1);

(3) Elimination of plant held for future use based on agreement of parties that PPLEU may accrue AFUDC on such plant (PPLEU Ex. Future 1 (Revised), Sch. C-3, p. 1);

(4) Adjustments to the projected level of customer deposits (Tr. 480); and

(5) Corrections to cash working capital (PPLEU Ex. Future 1 (Revised), Sch. C-4, p. 2).

(R.D. at 12).

The foregoing adjustments are reflected in PPL Exh. Future 1 (Rev), Sched. C-1 and reduce the rate base as of December 31, 2004, to $1,837,003,000. We will next discuss the remaining issues within the topic of rate base.

**A. Prepaid Postage**

 **1. Positions of the Parties**

According to PPL, its Cash Working Capital (CWC) claim includes a claim for the net lag in recovery of operating expenses based upon a lead/lag study and a separate claim for average prepayments. The OCA was the sole party to take issue with PPL’s inclusion of prepaid postage within its claimed rate base for the Future Test Year. According to the OCA, PPL’s claim for prepaid postage in the average prepayment balances, as well as within its CWC lead/lag study, results in a double recovery.

The OCA averred that PPL has calculated the lead days from the postage prepayment date to the date the postage was used, thus, the lead/lag study fully captured the applicable working capital requirement. (R.D. at 14).

PPL stated that the period of time captured in its lead/lag study for this issue is from the date the bills are mailed to the date payment is received from customers, thus, excluding the time period from when the postage is paid to when it is expensed. (R.D. at 15.)

**2. ALJ Recommendation**

The ALJ found that the OCA did not adequately support its claim regarding how the prepaid postage was incorporated into the Company’s lead/lag study, and therefore, denied the adjustment.

**3. Exceptions**

In its Exceptions, the OCA maintains that the calculation of negative lag days was based upon the date of the prepayment to the date the postage was used. This has the effect of reflecting the prepaid postage in the lead/lag study and thus in the CWC that is included in rate base and earns a return. In its Reply Exceptions, PPL rejoins that the OCA’s adjustment is inconsistent with prior practice and should not be allowed.

**4. Disposition**

Based upon the evidence of record, we deny the Exceptions of the OCA and adopt the recommendation of the ALJ. We find that the Company’s position, that the period of time captured in its lead/lag study for this issue is from the date the bills are mailed to the date payment is received from customers, effectively refutes the OCA’s argument of double counting, since the time period from when the postage is paid to when it is expensed is excluded.

**B. Cash Working Capital**

The OTS and the OCA presented an adjustment to PPL’s calculation of lead/lag days used for the materials and supplies segment of CWC. PPL agreed with the restatement of lead/lag days for this calculation and it also agreed to a $389,000 reduction to its $22,797,000 CWC claim. The OCA also proposed that the CWC claim be reduced to reflect its adjustments to operation and maintenance expenses.

The ALJ supported PPL’s agreement with both the OTS and the OCA, regarding the number of days to be used in calculating the materials and supplies segment of CWC. Regarding the OCA’s second adjustment, the ALJ did not adopt all of the expense adjustments proposed by the OCA and therefore, could not adopt their exclusion from the operation and maintenance segment of the calculation of CWC. The ALJ, however, does recommend that the final level of allowable operation and maintenance expenses be incorporated into the final calculation of the allowance for CWC. No party filed Exceptions to the ALJ’s recommendation on this issue. We find the ALJ’s finding and recommendation to be reasonable and adopt it as our own, without comment.

**V. REVENUES**

PPL proposed $2,946,995,778 in total revenue, for an 8.14% increase. (PPL Exh. Future-1 (Rev), Sched. D-3 at 7A). The revenue increase and historic and future test years calculated to produce the figures are set forth in the Direct Testimony of Oliver G. Kasper. (PPL St. 6 at 4-8; PPL Exh. Future-1 (Rev), Sched. D-3 at 1-7A).

**A. Unbilled Revenues**

**1. Positions of the Parties**

 PPL presented an adjustment to its Future Test Year by removing $2,395,000 of unbilled revenues, which represents the value of services provided but yet unbilled before the close of the test period.

 The USDOD was the only party to present testimony against the Company’s unbilled revenues averring that they should not be removed from the future test year projection and should be reinstated. The USDOD’s basis for the reversal of the PPL adjustment is that: estimated budget figures are used to project the future test year claim; this creates a mismatch between revenues and expenses for the accounting period; and that PPL includes unbilled revenues for accounting and tax reporting purposes.

 **2. ALJ Recommendation**

 The ALJ relied on PPL’s arguments and recommended rejection of the USDOD adjustment of $2,395,000. (R.D. at 19). The ALJ found that USDOD confused the concepts of adjustments for accounting and tax purposes with the annualization and normalization adjustments used in forecasting test year revenues and expenses for ratemaking purposes that were employed by the Company in presenting its revenue forecast. No party filed Exceptions to the ALJ’s proposed resolution of this issue.

 **3. Disposition**

 We agree with the ALJ on this issue and deny the USDOD adjustment. We shall rely on the projections, as performed by the Company, as the basis for forecasting revenue in this proceeding. PPL’s forecast of future test year revenues properly accounts for normal weather conditions and on an annualized basis, the changes in the number of customers and changes in customers’ usage.

**B. Late Payment Fees**

 **1. Positions of the Parties**

 PPL included, in its forecasted revenue, a claim for late payment fees in the amount of $6 million, based upon the five-year average of actual experience. PPL asserted that the use of a five-year average will smooth out the effect of any short-term anomalies in the data used to calculate late-payment revenues. The OTS recommended, and PPL accepted, an adjustment to state properly the five-year average, without rounding, of $6,336,000. (OTS Exhibit No. 5, Schedule 1).

 The OTS then calculated a late payment revenue factor of 0.2818%, which is based upon a three-year weighted average of late payment revenue to total revenue. The OTS recommended that this factor be applied to the final revenue allowance as calculated by the Commission.

 The OCA agreed with the OTS’ rounding adjustment of $336,000 but also applied the Pennsylvania jurisdiction allocation factor, thereby reducing the rounding adjustment by $6,000. Additionally, the OCA supports the OTS’ use of the three-year average late payment revenue to total revenue to compute a factor that is applied to the final revenue allowance. (R.D. at 23).

 PPL did not challenge the use of the three-year late payment factor, as developed by OTS and supported by the OCA. The Company claimed, however, that this method should also be employed when considering the amount of uncollectible accounts expense to be factored into the final revenue allowance. (R.D. at 23). PPL applied a factor of 0.655%, representing the historical relationship of uncollectible accounts expense to revenue, to its proposed revenue increase to compute its uncollectible accounts expense for this proceeding. PPL claimed that the Commission should treat uncollectible accounts expense in the same manner, thereby netting out the OTS/OCA proposed increase in late payment revenue.

 Both the OTS and the OCA disagreed with PPL’s recommendation that the 0.655% uncollectible expense factor should be used within the iteration process at the conclusion of this proceeding. The OCA stated that many aspects of uncollectible accounts expense are within management’s control, unlike late payment revenue.

 **2. ALJ Recommendation**

 The ALJ recommended that the OTS’ three-year weighted average late payment revenue to total revenue factor be adopted because the underlying calculation is clearly set forth, as further adjusted for jurisdictional allocations. The ALJ determined that this methodology had been adopted by the Commission in the past and that PPL had not presented a persuasive argument to the contrary. The ALJ rejected PPL’s position that its uncollectible accounts expense should be treated in a similar fashion because its arguments and figures have not been presented to the other parties in litigation.No party filed Exceptions to the ALJ’s recommended resolution of this issue.

 **3. Disposition**

 The OTS and the OCA agree, and the Company did not except, to the use of a late payment revenue to total revenue factor in the iteration process to develop the final revenue increase allowance in this proceeding. We fully support and adopt the ALJ’s recommendation granting the use of the OTS three-year late payment revenue to total revenue factor methodology and rationale. Noting the ALJ’s rejection of OTS’ weather normalization adjustment, the present rate revenue must be increased by $739,452, and the 0.2818% late payment revenue to total revenue factor must be included within the iteration process to properly reflect the impact of increased revenue (billings) upon late payment revenues. PPL’s request to apply the same methodology to the calculation of uncollectible accounts expense is denied because the parties to this proceeding did not have the opportunity to examine this new claim at hearing and because many of the aspects of uncollectible accounts expense are within management’s control.

 **C. Sales Forecast**

 **1. Positions of the Parties**

PPL’s sales forecast is comprised of two major components: the number of customers, by class, at the end of the future test year and the projected changes in average annual usage by customers. The OTS is the only party to take issue with the changes in the annual usage component, for the residential class, in this forecast. The projected number of customers was not challenged. At issue is PPL’s use of a proprietary econometric software model, to which the OTS was not able to gain access.

 The OTS asserts that there are deficiencies within the PPL model such as its utilization of twenty-year data in lieu of the customary thirty-year data, the degree-day data used within the model contains estimates, or certain data is excluded when deemed erroneous. The main argument of the OTS is that PPL has not met its burden of proof because it uses an econometric model and weather data that is not available to the Parties and that such data is not part of the record.

 The model used by PPL matches the billing cycle degree-days with billing-cycle usage data which, it asserts, is a more accurate comparison than the OTS method­ology which employs calendar-month degree-days and usage-month sales data.

 OTS’s main argument was that the Company has not met its burden of proof because it uses weather data and an econometric model that is not available to the parties, and is not a part of the record. OTS argued that if it cannot examine and test the assumptions and data inputs to the METRIX ND model, its results cannot be used as evidence because they are not supported by evidence of record. OTS also argues that the Company’s projection is unacceptable because it uses a 20-year period as a basis for its projections, rather than the generally-accepted 30-year period.

 Regarding the accessibility of METRIX ND, the conduct of both parties is disappointing. The ALJ opined that the OTS should have been afforded an opportunity to test the model. If the issue is that the model is proprietary, then a Protective Order is available under the rules. 52 Pa. Code §§5.362, 5,423. If the issue is that the test cannot take place on Commission facilities, then staff should have been afforded the opportunity to use the server and have access to the PPL network. However, it appears that the parties stopped talking after the revelation that METRIX ND does not reside in Excel; it appears that there were no further negotiations. OTS did not file a Motion to Compel at that time, or a Motion to Strike relevant testimony later. Neither the Company nor OTS sought a Protective Order.

 The Company has obviously spent some time and money in developing the tools (METRIX ND and 20 years of data) with which it makes sales projections. It is obviously entitled to do so, and to use these tools to make its projections, which it feels are superior for its purposes. The ALJ opined that particularly in this new era of competition, the Company will want to be as accurate as possible in this area so it can plan accordingly.

 PPL noted several deficiencies in the OTS’ weather normalization calculation. First, cooling degree-days are not considered. Next, non-weather sensitive base load is based upon the month of October and therefore, is not properly calculated because October has a significant number of degree-days. Finally, the impact of indoor lighting requirements changes from the summer months to the winter months has not been addressed within the OTS methodology.

 **2. ALJ Recommendation**

 The ALJ found PPL’s methodology to be more accurate. The OTS’s method, which may be adequate for use in the natural gas industry because of the lack of cooling degree-days, falls short when attempting to forecast normalized usage for PPL, a dual-peaking electric distribution company. The ALJ recommended that PPL’s sales projection be adopted and that, on balance, there is sufficient evidence of record to support its results. The ALJ found that the OTS’ projections were not sufficiently suited to the electric industry to use in lieu of the PPL normalization forecast .

 **3. Exceptions**

 The OTS filed Exceptions regarding the methodology recommended by the ALJ and used by the Company to compute average usage per customer of 1450 Kwh. (OTS Exc. at 8 – 13). First, the OTS excepted to the ALJ’s reliance on twenty years of degree-day data in lieu of the traditional thirty-year heating degree-day data used in weather normalization adjustment computations for natural gas distribution companies. Next, the OTS excepted to the ALJ’s adoption of the Company’s matching of revenue months and degree days in place of the traditional monthly sales and monthly heating degree-day comparison. The OTS, nonetheless, stated that the individual differences between revenue months and calendar months are negated when the figures are annualized and that, if any differences remain, they would be miniscule. Finally, the OTS excepted to the Company’s use of a private company’s model to produce the annual usage per customer. The OTS was not able to test the model and therefore, believes that the Company has not met its burden of proof in support of the model.

 **4. Disposition**

 We concur with the ALJ’s finding that the methodology presented by the OTS does not accurately capture the essence of electric distribution company sales. The OTS methodology used October as the base load month, even though the degree days occurring in October were not insignificant. Additionally, the OTS model does not accurately account for the summer cooling usage of PPL’s customers in its normalization process. While OTS did not agree with the PPL econometric model, its perceived deficiencies are not supported on the record as being inappropriate or unreasonable. There is sufficient record evidence to support the use of PPL’s model. We therefore adopt the recommendation of the ALJ and deny the EXCEPTIONS of the OTS.

**D. Distribution System Improvement Service Charge**

 **1. Positions of the Parties**

PPL proposed implementation of a distribution system improvement Service Charge (DSIC) which would allow the Company to recover (between base rate cases) capital-related costs on certain capital investments in distribution facilities. (PPL St. 4 at 35). Specifically, the fixed costs recovered through the DSIC would include depreciation, a return on investment and income taxes associated with new projects placed in service each year. (OCA St. 2 at 4). The Company proposed three categories of distribution investments which would be eligible for cost recovery under the DSIC: (1) replacements for existing facilities that have worn out, are in deteriorated condition, or need to be upgraded to meet new regulations; (2) unreimbursed costs related to capital projects to relocate Company facilities due to highway relocations; and (3) security improvements that are recommended by a Federal or State governmental entity with appropriate jurisdiction over security matters. (PPL St. 4 at 35-36; OCA St. 2 at 4). PPL relies upon the automatic adjustment provision of the Code to support its request for a DSIC. 66 Pa. C.S. § 1307(a); (PPL M.B. at 112-121).

The Intervenors argue that Section 1307(a) should be read in conjunction with Section 1307(g), which provides for authority to implement automatic adjustment for distribution system improvements completed between base rate cases, but limits this recovery mechanism to water utilities. 66 Pa. C.S. § 1307(g). Although Section 1307(a) provides broad authority, the Intervenors maintain that Section 1307(g), which was added much later, provides for a limitation of that authority.

 The OCA and the OSBA opposed PPL’s proposed DSIC. (OCA M.B. at 187-205; OSBA M.B. at 22-27). The OCA and the OSBA argued that the proposed DSIC would violate Pennsylvania law. (OCA M.B. at 195-202; OSBA M.B. at 22-27). The OSBA noted that the proposed DSIC would constitute impermissible single issue ratemaking. (OCA M.B. at 190-195; OSBA St. No. 1 at 4). The OCA argued that the proposed DSIC would not permit appropriate regulatory review. (OCA M.B. at 202-204). The OSBA observed that PPL does not need the mechanism, as evidenced by the Company’s claims of reliability and its lack of any claim that a DSIC would impact the amount spent to improve the system. (OSBA M.B. at 25-26). Finally, the OSBA maintained that implementation of the proposed DSIC would be incongruous with PPL’s rate design philosophy of allocating costs based upon the cost of service to a particular customer class. (OSBA M.B. at 26).

PPLICA also opposed implementation of a DSIC, arguing it would result in single-issue rate making and eliminate regulatory review. (PPLICA M.B. at 51-52.) PPLICA noted that PPL submitted no evidence of financial necessity and thus, a DSIC would permit PPL to over-earn on its rate of return. (PPLICA M.B. at 49-51.) PPLICA also argued that the proposed DSIC would contravene statutory requirements in that the statutory authority, under 66 Pa. C.S. § 1307(g), to allow a surcharge for certain system improvements is limited to water utilities. (PPLICA M.B. at 52-57.) Finally, PPLICA observed that implementing a DSIC on a per kWh basis fails to account for cost causation. (PPLICA M.B. at 57-59.)

The OTS opposed PPL’s proposed DSIC, arguing that such a DSIC would violate Pennsylvania law and would constitute impermissible single-issue ratemaking. (OTS M.B. at 62-64). The CAC also opposed the implementation of a DSIC, citing the prohibition on single-issue ratemaking. (CAC M.B. at 5). The CCC opposed implementation of the proposed DSIC, arguing, *inter alia*, that an automatic pass-through would eliminate incentives to control costs and cause rate inequities. (CCC M.B. at 10-13).

**2. ALJ Recommendation**

The ALJ rejected the Intervenors’ argument regarding single issue ratemaking. Nevertheless, the ALJ recommended that the proposed DSIC be rejected, but also recommended “that a properly designed and approved DSIC be approved by the Commission after legislative input.” (R.D. at 32-47). The ALJ determined that, in order to approve a DSIC (or a DSIC-like mechanism), a utility must demonstrate a need for the repairs and for the automatic adjustment mechanism. (R.D. at 36-37).

The ALJ recognized that Section 1307 of the Code gave the Commission broad authority to fashion adjustment mechanisms. (R.D. at 42). However, the ALJ also determined that, with the passage of multiple amendments to Section 1307, the Legislature appears to have circumscribed the Commission’s authority to approve automatic adjustment mechanisms. (R.D. at 43). The ALJ refrained from recommending a DSIC for PPL without further legislative input. (R.D. at 43).

**3. Exceptions**

Exceptions were filed by PPL and the OSBA. PPL argues that no legislative input is necessary for the Commission to approve a DSIC for PPL. (PPL Exc. at 20-22). PPL restates its argument that Section 1307 of the Code provides sufficient legal authority for the DSIC. 66 Pa. C.S. § 1307; PPL Exc. at 16-20. PPL also excepts to the ALJ’s denial of a DSIC based on the adequacy of PPL’s facilities and its lack of “dire circumstances.” (PPL Exc. at 23-24; R.D. at 37). The OSBA objected to the ALJ’s finding that a properly designed DSIC should be approved after obtaining legislative guidance. (OSBA Exc. at 3-6).

Reply Exceptions were filed by PPL, the OTS, the OCA, the OSBA and PPLICA. The OTS argues that the ALJ correctly determined that PPL’s proposed DSIC lacked statutory authority. (OTS Reply Exc. at 14). The OTS maintains that the Code allows for DSICs only for water utilities. (OTS Reply Exc. at 14-17). The OCA urges the Commission to adopt the ALJ’s recommendation to deny PPL the proposed DSIC. (OCA Reply Exc. at 21-24). The OCA also takes issue with PPL’s capital investment figures and the design of the proposed DSIC, which the OCA argues ignores reductions and offsets. (OCA Reply Exc. at 21-22). The OSBA reiterates it position that the Commission lacks authority to implement a DSIC for any utility other than a water utility. (OSBA Reply Exc. at 4-5). PPLICA also argues that the Commission lacks the statutory authority to approve a DSIC for PPL. (PPLICA Reply Exc. at 12-16). PPLICA also raises the single issue ratemaking argument. (PPLICA Reply Exc. at 16-17).

In its Reply Exceptions, PPL takes issue with the OSBA’s characterization of the Declaration of Policy of the Competition Act. (PPL Reply Exc. at 15-16; OSBA Exc. at 5); 66 Pa. C.S. § 2802(16). Specifically, PPL argues that approval of a DSIC would not remove the Company or its rates and facilities from the active supervision of the Commission. (PPL Reply Exc. at 15).

**4. Disposition**

We agree with the ALJ’s disposition of this issue and deny the Exceptions of PPL and the OSBA. Although Section 1307 of the Code carves out exceptions to the general prohibition against single issue ratemaking, we must reject PPL’s request to implement a DSIC. 66 Pa. C.S. § 1307. The Company has not demonstrated a need for the DSIC or a need to by-pass the normal ratemaking process. Although PPL asserted that a DSIC would “facilitate” making the investment necessary to upgrade or replace its aging infrastructure, the Company did not submit evidence that the repairs would not be made if the DSIC is not available. Nor did PPL demonstrate it was approaching serious reliability problems. (R.D. at 36, 46). Additionally, the Commission notes the current uncertainty associated with its authority to approve automatic adjustment mechanisms beyond our water utilities. *See* *Popowsky v. Pennsylvania Public Utility Commission*, Docket No. 2497 C.D. 2003 (Pa. Cmwlth. Ct.).

**VI. EXPENSES**

**A. Rate Caps**

 **1. Positions of the Parties**

The OCA and PPLICA argued that costs, such as Hurricane Isabel repair costs and Automated Meter Reading (AMR) employee displacement costs, incurred during the period that the rate cap is in effect must be recovered through revenues collected from rates in effect during that period. (OCA M.B. at 25-30, 33-34; PPLICA M.B. at 31-37). Otherwise, according to the OCA and PPLICA, there is a *de facto* rate cap exception or violation. (OCA M.B. at 25, 33; PPLICA M.B. at 31). Both the OCA and PPLICA cited to *ARIPPA*[[3]](#footnote-3) to support their contention that a utility may not defer costs for collection until after the end of the rate cap. (OCA M.B. at 25, 33; PPLICA M.B. at 34).

PPL maintained that the Act addresses changes in rates, but does not address the collection of costs. (PPL M.B. at 35-36). PPL also argues that OCA misinterprets *ARIPPA*, claiming that the GPU costs were denied because they altered the company’s stranded costs. (PPL M.B. at 36-37). PPL argues that the Commission has long allowed utilities to amortize extraordinary storm damage. (PPL M.B. at 33).

 **2. ALJ Recommendation**

The ALJ determined that prospective recovery of deferred Hurricane Isabel expenses would not violate the rate cap. (R.D. at 52). The ALJ reasoned that basic rate making procedures apply and recognized the Commission’s long-standing policy of allowing a utility to recover some compensation for extraordinary or abnormal, large historic costs through amortization. (R.D. at 52). Still, the ALJ cautioned that a ruling that the claims are permissible as amortization claims does not mean they would be granted, although she did recommend approval for recovery of the hurricane expenses, with some adjustment. (R.D. at 52, 57).

The ALJ noted that there are Exceptions for certain kinds of expenses which may be collected before the rate cap expires. (R.D. at 53). Nevertheless, the ALJ concluded that the Competition Act expresses no limitation on rate case claims that may be made after the rate cap expires. (R.D. at 53). Under this reasoning, the ALJ recommended that the Commission find that the rate cap does not bar PPL from making either of these claims.

 **3. Exceptions**

The OCA and PPLICA filed Exceptions to the ALJ’s determination. The OCA and PPLICA restate their arguments that allowing future recovery of Hurricane Isabel costs and AMR displacement costs would constitute a *de facto* rate cap exception and violate Section 2804(4) of the Competition Act. (OCA Exc. at 12 and 15; PPLICA Exc. at 5-7). The OCA further relies upon the Commission’s language in *Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Interim Relief Pursuant to Section F.2 of Their Approved Restructuring Plan*, Docket Nos. P-00001860 and P-00001861 (February 21, 2001) (*Met-Ed & Penelec Reconsideration Order*).

PPL filed Reply Exceptions, reasserting its reliance on case law permitting recovery of extraordinary storm damage. PPL reasons that the rate cap provisions do not invalidate traditional ratemaking. (PPL Reply Exc. at 8). PPL concludes that because traditional ratemaking permits extraordinary, non-recurring expenses to be deferred and amortized following the first rate case after the expenses occurred, it should not matter that the expenses were incurred during the rate cap period. (PPL Reply Exc. at 9). PPL emphasizes that recovery will occur after the rate cap period has ended. (PPL Reply Exc. at 8).

 **4. Disposition**

We shall deny the Exceptions of the OCA and PPLICA and adopt the recommendation of the ALJ for this matter. The court in *ARIPPA* did *not* expressly determine that all costs incurred during a rate cap period but deferred for recovery until after the rate cap had expired constitutes a rate cap exception. *See generally, ARIPPA*. While the Commission’s prior decision in *Met-Ed & Penelec Reconsideration Order* did find that the routine energy costs Met Ed and Penelec wanted to recover would have to fall within the Exceptions to the rate cap provision, the question of extraordinary, storm-related costs was not addressed.

Although PPL incurred the costs associated with Hurricane Isabel during its rate cap period, these costs are not those routinely incurred. Moreover, PPL’s proposed rate increase and the hurricane expense amortization will not begin until after the Company’s transmission and distribution rate caps have ended. As stated by the ALJ, “all expenses normally included for ratemaking purposes may be included in rates to be put into effect after the rate cap expires.” (R.D. at 53). Accordingly, we find that the rate cap provision of the Competition Act does not bar PPL from recovering expenses related to Hurricane Isabel or its AMR severance packages.[[4]](#footnote-4)

**B. Hurricane Isabel**

 **1. Positions of the Parties**

PPL seeks recovery of a $15 million regulatory asset through a five-year amortization period, without earning a return on the uncollected amounts.[[5]](#footnote-5) (PPL St. 4 at 40, 44-45). PPL claims a total hurricane-related loss of $17.2 million, but the Company was not permitted to defer capitalized costs. (PPL St. 4 at 42); *Petition of PPL Electric Utilities Corporation for Authority to Defer for Accounting Purposes Certain Losses from Extraordinary Storm Damage and to Amortize Such Losses*, Docket No. P-00032069 at 7 (*PPL Storm Petition*). The expense items PPL included in the $15 million amount include: wages, including overtime; expenses for outside crews; expenses for vehicles and equipment; expenses for customer outreach; and equipment charges. (PPL St. 4 at 42).

The OTS agreed that the claim for losses incurred as a result of Hurricane Isabel is permissible, but argued that PPL overstated the expenses and amortized the expense over an insufficient length of time. (OTS St. 2 at 17). Specifically, the OTS objected to PPL’s inclusion of regular time employee wages and benefits. The OTS argued that regular wages and benefits are ordinary expenses that would have been incurred regardless of the hurricane. (OTS St. 2 at 17). The OTS also maintained that the proper period of amortization is ten years in order to match the infrequent nature of a storm the size of Hurricane Isabel. (OTS St. 2 at 18).

The OCA and PPLICA argued that the hurricane expenses were incurred during the rate cap period and therefore, were ineligible for recovery either during the rate cap period or after the rate caps had terminated. (OCA M.B. at 25-30; PPLICA M.B. at 31-36). Citing *ARIPPA v. Pennsylvania Public Utility Commission*, 792 A.2d 636 (Pa. Cmwlth. Ct. 2002) (*ARIPPA*), the OCA argued that a utility may not defer for collection costs incurred during the rate cap period until after the rate cap terminates. (OCA M.B. at 25).

 **2. ALJ Recommendation**

The ALJ held that recovery of the hurricane expenses was not subject to the rate cap provision of the Competition Act. The ALJ distinguished the instant request from the *ARIPPA* case, noting that PPL does not seek a rate cap exception, but rather, seeks to collect the disputed costs through its basic rates after the rate cap expires. (R.D. at 51).

However, the ALJ agreed with the OTS position that the regular wages and benefits should be removed and the amortization period should be extended. The ALJ reasoned that the Commission’s practice is to try to match the amortization period to some extent with the timing of the outstanding event causing the expense that is to be amortized. Because storms of the magnitude of Hurricane Isabel are rare occurrences, the amortization period should be extended to ten years.

 **3. Exceptions**

Exceptions were filed by PPL and the OCA. PPL argues that a ten-year amortization period is unreasonable where no return is allowed on the unamortized balance. (PPL Exc. at 31). PPL also argues that recovery of regular wages and benefits should be permitted to cover the increased costs of overtime and outside services to make up for delays in routine work. (PPL Exc. at 31).

The OCA argues that the ALJ incorrectly determined that PPL’s claim for hurricane-related costs differs from those in *ARIPPA*. (OCA Exc. at 9). The OCA argues that deferral of costs with recovery after the rate cap period constitutes a request to exceed the rate cap. (OCA Exc. at 9).

 **4. Disposition**

As discussed, *supra*, we agreed with the ALJ that the prospective recovery of deferred Hurricane Isabel expenses does not violate the rate cap. Moreover, the Commission has a long-standing practice of allowing utilities to collect compensation for extraordinary or abnormal and large historic costs through amortization.

We also agree that the amortization period proposed by PPL is inadequate. As discussed by the ALJ, the amortization period should correlate with the timing of the event that gave rise to the expenses to be amortized. Given PPL’s testimony that it had not experienced a storm the magnitude of Hurricane Isabel in eighty years, an amortization period of five years is simply too short. (PPL St. 4-R at 39). When faced with expenses associated with Hurricane Agnes, the Commission utilized a ten-year amortization period for recovery of costs.  *The Bell Telephone Co.*, 55 Pa. P.U.C. 97, 109-110 (1981). Accordingly, we find an amortization period of ten years to be reasonable in this instance.

We further agree that the hurricane expenses should not include regular wages and benefits. Certainly, PPL would incur regular wages with or without Hurricane Isabel. The ALJ properly excluded those costs in her recommendation. Accordingly, we deny the Exceptions of PPL and the OCA and approve recovery of costs associated with Hurricane Isabel, less the OTS recommended adjustment for regular wages and benefits, and amortized over a period of ten years. Thus, after reducing the regulatory asset by the amount of regular benefits and wages and extending the amortization period, hurricane-related operation and maintenance (O&M) expenses will be reduced by $1,850,500.

 **C. Employees’ Severance Costs from AMR**

 **1. Positions of the Parties**

PPL has initiated an Automated Meter Reader (AMR) program to convert all of its 1.3 million customers’ meters to automated meters, which can be read remotely. Installation began in the spring of 2002 and is expected to be completed by September 30, 2004. (PPL St. 4 at 10-11). While PPL cited to several benefits from switching to AMRs, one of the downsides is the cost of displaced employees. (PPL St. 4 at 12-18). With the elimination of jobs that are no longer needed, PPL offered enhanced severance benefits to more than 90 departing employees. (PPL St. 4 at 18). PPL estimated the cost of the enhanced benefits to be $8.8 million. (PPL St. 4 at 18). PPL proposed to amortize this amount over a five-year period, for an increase in distribution operating expense of $1,764, 000 in each of those years. (PPL Exh. Future-1, Schedule D-2 (Revised)).

The OCA and PPLICA argued that this claim is barred by the rate cap provision of the Competition Act. (OCA M.B. at 33-34; PPLICA M.B. at 36-37). The OCA also maintained that the program does not have a net economic benefit based on the figures presented by PPL. The OCA argued that the cost of allowing this expense exceeds any purported benefits of the AMR program and ratepayers would be economically better off without AMR. (OCA St. 2 at 13). The OCA further noted that the termination charge at issue here is a one-time accrual under Statement of Financial Accounting Standards (SFAS) 88. According to the OCA, this did not require a cash outlay by PPL because its pension trust fund balance is over-funded. (OCA St. 2 at 12). Moreover, depending on the performance of the pension trust fund, OCA opined that PPL may never be required to make a cash contribution. (OCA St. 2 at 14).

The OTS also opposed this claimed expense. The OTS argued that the pension trust is an entity separate from the Company. Accordingly, the OTS reasoned that PPL’s AMR displacement costs claim should be rejected because the claim will be paid by the pension trust and ratepayers have already paid these costs through past pension expenses included in base rates. (OTS St. 2 at 20).

 **2. ALJ Recommendation**

The ALJ recommended that PPL’s claim for recovery of $8.8 million of AMR displacement costs should be rejected. (R.D. at 62). The ALJ noted that the claim is neither a large expense that has been paid nor a large loss that requires devotion of a concentration of the Company’s resources to overcome. (R.D. at 62). Because no payment was made, and none may ever have to be made, the ALJ reasoned that PPL should submit a claim in a rate case when and if that payment is required. (R.D. at 62). The ALJ determined that the claim is, in effect, a virtual expense, which was neither paid nor incurred by PPL. (R.D. at 62). The ALJ concluded that amortization was not designed to cover this kind of expense. (R.D. at 62).

 **3. Exceptions**

Exceptions were filed by PPL, the OCA and PPLICA. PPL excepts to the ALJ’s characterization of this expense as “not large.” (PPL Exc. at 30). PPL also contends that its basis for proposing amortization is to treat the expense similarly to the capital costs of the AMR system. (PPL Exc. at 30). PPL also argues that its pension expense has been based upon accrual accounting and treating special enhanced pension benefits on a cash basis would be inconsistent. (PPL Exc. at 30).

The OCA and PPLICA reiterate their positions that this claim is barred under *ARIPPA* as a violation of rate cap provisions. (OCA Exc. at 14-15; PPLICA Exc. at 4).

Reply Exceptions were filed by the OCA, the OTS and PPL. The OCA and the OTS argue that the ALJ correctly denied PPL’s claim because PPL may never have to make any cash outlay for this expense. (OCA Reply Exc. at 3-4; OTS Reply Exc. at 4-5). PPL reiterates its argument that the AMR expenses do not fall within the rate cap provision of the Competition Act. (PPL Reply Exc. at 7-10).

 **4. Disposition**

We agree with the ALJ that PPL’s claim for recovery of $8.8 million of AMR displacement costs should be rejected. PPL is not required to make any payments for the AMR severance packages. Because no payment was made, and none may ever have to be made, the claim is, in effect, a virtual expense. As recognized by the ALJ, amortization was not designed to cover theoretical expenses. (*See* R.D. at 62). Accordingly, we deny the Exceptions of PPL, the OCA and PPLICA and direct that PPL’s claimed annual expenses be reduced by $1,764,000.

**D. Epstein Adjustments**

Complainant Eric Epstein argued that the layoffs resulting from the introduction of Automated Meter Readers (AMRs) harm the employees that were laid off. Mr. Epstein further reasoned that because these former employees are members of the community, the community will be harmed by the loss of income the former employees earned. Mr. Epstein argued that PPL customers should not have to pay to fund layoffs of their neighbors and underwrite costs of a program that has harmed the community and produces little benefit to customers. (Epstein St. 1 at 6). Mr. Epstein argued that the AMR technology becomes a net loss for rate payers if they are forced to pay for this program. (Epstein St. 1 at 6).

The ALJ recommended rejection of PPL’s claim of severance costs resulting from the AMR program. Accordingly, the ALJ did not elaborate upon this issue, but did conclude that “community harm” is not recognized as a basis for adjustment for ratemaking purposes. (R.D. at 63). No Exceptions to the ALJ’s proposed disposition of this issue have been filed.

 We shall adopt the ALJ’s recommendation to deny recovery of PPL’s AMR-related severances expenses. We also shall adopt the ALJ’s recommendation regarding Mr. Epstein’s proposed adjustment.

**E. Pension Expense**

 **1. Positions of the Parties**

PPL claimed $2,517,986 for distribution-related Retirement Plan and Supplemental Executive Retirement Plan (SERP) pension expenses, $1,750,000 of which is proposed to be allocated in O&M and $767,986 to be allocated in rate base. (R.D. at 64).

The OTS did not object to the inclusion of the SERP expenses. The OTS noted that the SERP is an unfunded plan and any contributions to that plan are equivalent to actual benefit payments. (OTS St. 2 at 12).

However, the OTS argued that because the Company’s Retirement Plan pension expense is based upon SFAS 87 and is an accrued expense, PPL’s O&M claim of $1,396,976 should be denied and the corresponding capitalized portion of the expense of $613,062 should be removed from rate base. According to OTS, allowing the Company to collect money for payments that are not made results in a windfall for the Company. (OTS St. 2 at 12).

 In its Main Brief, the OTS cites *Pennsylvania Public Utility Commission v. Aqua Pa*., Docket Number R-00038805 (August 5, 2004), as support for its position which denies the pension expense claim and related capitalized portion of $1,396,976 and $613,062, respectively. In *Aqua*, the Commission allowed an expense, for ratemaking purposes, which was based upon the average of the Employee Retirement Income Security Act (ERISA) minimum requirements and the IRS maximum deduction allowance. *Id.* at 32. The average of these two measures provided for a positive amount to be payable to the pension fund for ratemaking purposes.

 **2. ALJ Recommendation**

The ALJ rejected the OTS’ adjustment and recommended that PPL’s pension expense claim be granted. (R.D. at 66). The ALJ reasoned that PPL was permitted to recover these expenses in its last base rate case. The ALJ also determined that the fact that PPL is now a distribution company but was a fully integrated utility at the time of its last base rate case did not support the OTS’ argument that a change in circumstances made the adjustment appropriate in this case. (R.D. at 65).

The ALJ cited the Commission’s Opinion and Order in PPL’s prior rate case where we rejected the calculation of pension expenses on a cash basis and instead, used an accrual basis. (R.D. at 65). In PPL’s prior base rate case, we held that “*consistent* use of the accrual should be fair to both rate payers and stockholders, over the long term.” *Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company*, 85 Pa. P.U.C. 306, 329 (1995) (emphasis in original).

**3. Exceptions**

The OTS excepted to the ALJ’s determination, arguing that the ALJ has misconstrued regulatory and accounting principles. (OTS Exc. at 14). In its Exceptions, the OTS argues that proper ratemaking principles require that the capitalized portion of PPL’s claimed pension expense be rejected. (OTS Exc. at 8). The OTS restates its argument that PPL was permitted to recover this expense in its last base rate case, amounting to approximately $10 million per year. (OTS Exc. at 15). In the ten years since that case, PPL has made no contributions to the pension plan. (OTS Exc. at 15). Had PPL made contributions with the revenue it collected for that purpose or placed the funds in escrow, the Company would not have any of its currently claimed pension liability. (OTS Exc. at 15).

In its Reply Exceptions, PPL states that although it has no present obligation to make a cash contribution, it does have a liability under SFAS 87 of approximately $75 million. This $75 million is an unfunded accumulated benefit obligation, which is the amount by which the present value of the accrued pension costs exceeds the fair value of plan assets. (PPL Exc. at 18-19).

PPL also reiterates its position that fairness dictates the use of a consistent methodology. (PPL Reply Exc. at 18). PPL cites to its prior rate case, in which we approved pension expenses based on accruals. (PPL Reply Exc. at 17). PPL argues that switching between methodologies is grossly unfair and opportunistic. (PPL Reply Exc. at 18).

**4. Disposition**

We deny the Exceptions of the OTS and adopt the recommendation of the ALJ on this issue. As stated by the ALJ, in the past, PPL has calculated pension expenses on an accrual basis. The OTS offered no rationale to move from an accrual basis to a cash basis, other than we recently approved expenses for another utility based on a cash basis. Alternating among various methodologies is unfair to ratepayers and stockholders. Utilities should be able to rely upon a previously-approved methodology in preparing for future rate cases. There is no justification for changing PPL’s methodology at this time. Accordingly, we approve the Company’s revised claim for both O&M expenses and rate base.

 **F. United States Department of Defense Adjustment to Injuries & Damages**

As part of its detailed budget process, PPL requested recovery for injuries and damages expense of $1,517,000. (PPL St. 2 at 13-17). PPL had experienced injuries and damages expenses of $1,374,198 in 2001, $1,325,470 in 2002 and $1,169,000 in 2003. PPL maintained that its Historic Test Year expense was abnormally low.

The United States Department of Defense (USDOD) argued that the proper amount is the figure from the Historic Test Year, $1,169,000. The USDOD offered virtually no analysis for its position and did not challenge PPL’s budget process. (USDOD St. 1 at 9).

The ALJ rejected the USDOD adjustment and recommended approval of the amount claimed by PPL, $1,517,000. (R.D. at 66-67). The ALJ determined that there was no basis to believe that PPL’s injuries and damages will remain at the historic test year level of expense. (R.D. at 66-67). The ALJ also noted that PPL could reasonably expect some impact from inflation and other increases. (R.D. at 67). No Party filed Exceptions to this issue.

We agree with the ALJ’s determination on this issue. PPL’s claimed expense of $1,517,000 offers a reasonable estimation of injuries and damages expense, adjusted for external influences.

 **G. Employee Health Insurance Expense**

 PPL self-insures its employee health insurance and thus, maintains a reserve fund to pay employee claims as they become payable. The normal processing time of medical claims results in a lag between the rendering of medical services to employees, under employer-sponsored plan, and the time the costs for those services are submitted by the health care provider to the insurance carrier and ultimately to PPL for payment. Generally Accepted Accounting Principles in the United States require the accrual of this estimated lag, which is referred to as medical claims Incurred But Not Reported (IBNR) liability. Standard practice is to reserve between sixty and ninety days of claims lag.

The USDOD is the only party to present an adjustment to the Company’s health insurance expense. The adjustment presented, however, is based solely upon a temporary timing difference between when an employee receives medical care and when the Company pays the claim. The USDOD’s adjustment suggests a refund to customers of the projected liability reserve, over a three year period. PPL has projected no change in the liability reserve from the end of the historic test year to the end of the future test year and asserts that the reserve is reasonable and appropriate for this self-insured employee benefit.

The ALJ found the Company’s claim to be reasonable and recommended that the USDOD adjustment be denied. (R.D. at 68). No Party filed Exceptions on the ALJ’s determination of this issue. We find the ALJ’s recommended disposition of this issue to be reasonable and adopt it as our own, without further comment.

 **H. Environmental Remediation Expense**

1. **Positions of the Parties**

 PPL originally claimed $3,556,000 as an annual level of Environmental Remediation expense. Based upon the testimony of the OTS and the OCA, PPL revised its claim to $1,073,000. The revised figure results from the use of a three-year average of actual remediation expenses. PPL has incorporated this reduced expense into its revised future test year claim.

 The USDOD and Strategic take issue with this claim based upon its intended use, which is to clean up manufactured gas plant sites and that ratepayers may not be responsible for this type of activity. Also, the USDOD and Strategic contend that some of the manufactured gas plant sites may have been sold at a profit and that gain should have been used to mitigate the future costs of remediation. Mr. Epstein argued that the original claim was overstated because it was based upon the Company’s clean up of polychlorinated biphenyl (PCBs) at a single site.

 The USDOD and Strategic state that ratepayers *may* not be responsible for the payment of these environmental costs. PPL has asserted that it is completely appropriate for ratepayers to bear the costs of environmental remediation *at manufactured gas plant sites*. PPL further stated it believes that, under various state and federal laws, PPL may be *wholly or partially responsible* for the remediation costs at certain facilities that were owned and operated by the Company or its predecessors. Consequently, these liabilities remained with PPL during its restructuring proceeding in 1998. PPL reasoned that such sites were clearly used to provide public utility service and customers should pay for costs of remediation those sites. PPL stated that it has not sold any manufactured gas plants for a profit.

**2. ALJ Recommendation**

 The ALJ recommended adoption of the revised PPL claim of $1,073,000, which is based upon a three-year average of actual environmental remediation expenses, and that the assertion that PPL sold some of its manufactured gas plants at a profit is not supported by record evidence.

 **3. Exceptions**

 Mr. Epstein filed Exceptions to the ALJ’s recommendation. Mr. Epstein believes the $532,000 requested increase over the historic test year actual expense is arbitrary and should be rejected. He also states that only PCB remediation expense should be allowed. (Epstein Exc. at 4-7).

 **4. Disposition**

We agree with the ALJ that the revised claim is reasonable. Mr. Epstein has not responded to the revised expense claim and the OTS and the OCA have agreed to accept the claim. We also find that the assertion that PPL sold some of its manufactured gas plants at a profit to be unsupported by the record. Accordingly, the revised PPL claim of $1,073,000 is adopted.

1. **Proposed Reductions in OnTrack and WRAP Funding by OCA and OTS**

**1. Funding for OnTrack**

 **a. Positions of the Parties**

OnTrack helps customers with income at or below 150% of the Federal Poverty Level to maintain electric service through reduced payment plans and arrearage forgiveness. (PPL M.B. at 136, PPL St. 7 at 4). Currently, annual funding from ratepayers is $11,700,000 (PPL St. 7 at 11-12). PPL proposes a 25.6% per year increase for OnTrack, $11.7 million to $14.7 million, in order to increase enrollment from 12,420 customers to 15,000 - 17,000 customers.[[6]](#footnote-6) (PPL M.B. at 136).

Consistent with the procedures used to implement the 1998 restructuring settlement agreement, the Company has proposed that this $3 million OnTrack funding increase be “ramped up” by increasing annual spending by $1 million per year through 2007, with the difference in ratepayer funds collected and spent in 2004-07 escrowed to permit higher expenditures ($15.7 million instead of $14.7 million) in years 2008-2010.

(PPL M.B. at 136; PPL St. 7 at 12).

 The Commission on Economic Opportunity (CEO) agrees that increased enrollment and funding for OnTrack is necessary but argues that PPL’s proposed changes to the program still will not aid enough customers. (CEO M.B. at 10). CEO proposes that OnTrack funding be increased to a level that will serve 30,000 customers. (CEO M.B. at 20).

 The OCA and the OTS both generally agree with the increase in enrollment and funding levels for OnTrack. (OCA M.B. at 156). However, the OCA and the OTS propose to limit the increase in funding to a two-year period. (OCA St. 5 at 37; OTS St. 2 at 29-30; Tr. at 856-857). They propose to normalize the increase and would allow $13.2 million, the average of the amounts PPL plans to spend in 2005 and 2006 ($12.7 + $13.7 = $26.4 ÷ 2 = $13.2). (OCA St. 5 at 37; OTS St. 2 at 29-30; Tr. at 856-857).

 **b. ALJ Recommendation**

 ALJ Turner recommended that the Commission approve PPL’s enrollment goal for OnTrack. (R.D. at 166). The ALJ further recommended the approval of the two-year normalization of the program’s costs which was proposed by the OCA and the OTS. (R.D. at 164). The ALJ also recommended that if the Commission were to approve the full amount requested by PPL, then the escrowed funds should be kept in an interest bearing account. (R.D. at 164).

 **c. Exceptions**

PPL filed Exceptions to the ALJ’s recommendation and argues that the proposed 25.6% increase should be granted for the period 2005-2010. PPL states that the proposed ramp up period is needed for the community organizations involved in delivering OnTrack to maintain administrative costs while increasing enrollment by over 30%. (PPL Exc. at 35). PPL argues that if it does not file another rate case within two years, the program will be under-funded and low-income customers may be denied program benefits. (PPL Exc. at 35). PPL commits to using all OnTrack funds collected to expand enrollment in the program as quickly and efficiently as possible. (PPL Exc. at 35). PPL agrees that if any OnTrack funds remain unspent in the 2005-2007 period, the Company will escrow those monies in an interest-bearing account for expenditure in subsequent years. (PPL Exc. at 35).

 In its Reply Exceptions, the OCA states that the problem with PPL’s proposal is that PPL has testified that it intends to file another base rate case within two years. (OCA Reply Exc. at 20; OCA St. 5 at 37). The OTS also filed Reply Exceptions restating that the program has a ramp up period where excess funds will be collected early with under collection in later years. The OTS opines that subsequent rate cases can address funding after the initial two year period. (OTS Reply Exc. at 7).

 **d. Disposition**

We will adopt the ALJ’s recommendation regarding the two-year normalization for OnTrack expenses. PPL has stated that it will file its next base rate case in two years, and has claimed a two-year normalization period for rate case expense. The increased spending levels for Year 2007 and beyond can be addressed in the next base rate case. Therefore, PPL’s Exceptions on this issue are denied.

1. **Funding for WRAP**
	1. **Positions of the Parties**

PPL proposes a $1 million increase in funding for its Winter Relief Assistance Program (WRAP), from $5.7 million to $6.7 million, an increase of 17.5%. (PPL St. 7 at 11; PPL M.B. at 143). PPL intends to ramp up expenditures through Year 2011.[[7]](#footnote-7) PPL states that, based on historical costs, the increased funding will allow it to serve approximately 3,200 customers per year, 12% more customers than those served in the winter of 2002-2003. (PPL St. 7 at 13). PPL plans to implement solar water heating as a standard WRAP measure, based upon its successful solar water heating pilot program. (PPL St. 7-R at 21).

 The CEO proposes increasing WRAP funding to $7 million of which $1 million would be allocated to solar hot water applications. (CEO M.B. at 17; CEO St. 2 at 23).

 The OTS recommends the allowance of $6,250,000 for WRAP-related expenses. (OTS M.B. at 31). As with the OnTrack program, the OTS recommends normalizing the Year 2005 and Year 2006 expenses. (OTS M.B. at 31).

 The OCA also disagrees with the Company’s proposal to normalize the expense for the program over such an extended period of time and instead recommends a two-year normalization of the expense. (OCA M.B. at 173; OCA St. 5 at 37).

**b. ALJ Recommendation**

ALJ Turner recommended that the Commission accept the Company’s proposal subject to the OCA/OTS two-year normalization adjustment. (R.D. at 167).

 **c. Exceptions**

 The CEO, in its Exceptions, contends that PPL should be ordered to increase WRAP funding to $7 million in 2005, of which $1 million annually would be used to expand the solar hot water program. (CEO Exc. at 14). The CEO also contends that the ALJ failed to order PPL to continue to use local community based organizations in implementing its WRAP program as agreed to by the Company. (CEO Exc. at 14).

 Mr. Epstein, in his Exceptions, contends that the Commission should set a ceiling on the ratio of ratepayer money used to administer universal service programs. Mr. Epstein noted that almost 20% of WRAP costs for 2005-2007 represent administrative costs. (Epstein Exc. at 21).

 **d. Disposition**

 We will adopt the ALJ’s recommendation as well reasoned and based on the record evidence. With regard to the CEO’s concerns, review of the record reveals that PPL plans to continue employing the services of local CBOs to install WRAP equipment. (Tr. at 734-735). Additionally, PPL plans to implement solar water heating as a standard WRAP measure. (PPL St. 7-R at 21). We note that, per our 2003 *Universal Service Compliance Order,* PPL is to submit a third party evaluation of the WRAP program and its costs to the Commission’s Bureau of Consumer Services in April 2006. Accordingly, the Exceptions of the CEO and Mr. Epstein are denied.

 **J. OCA’s Additional Expense Adjustments**

Throughout the course of this proceeding the Company, the OCA and the OTS were able to reach agreement on several expense adjustments including Community Affairs Expense (PPL, OCA and OTS); Expiring Amortizations and Amortization of Deferred Taxes Related to Removal Costs (PPL, OCA and OTS); Pension Expense (PPL and OCA), and Postretirement Benefits other Than Pensions (PPL and OCA).

 In her Recommended Decision the ALJ disposed of the issues by stating that the parties had reached agreement. The Recommended Decision did not specifically adopt or reject these adjustments. Based upon the record of this proceeding however, regarding these issues, we find them to be reasonable and shall adopt them.

 **1. Community Affairs Expense**

 The Company agreed with the OCA and the OTS that this expense claim was overstated and reduced its claim by $232,000 on a jurisdictional basis. This reduced claim is reflected in the Company’s updated Future Test Year exhibits.

**2. Expiring Amortizations: Power Management Software and Amortization of Deferred Taxes Relating to Removal Costs**

This claim will be fully recovered by the end of Year 2004 and should not be included within the cost of service on a going forward basis. The OCA and the OTS recommended, and the Company agreed to, remove the $529,587 expense claim.

 **3. Pension Expense**

 The Company and the OCA have agreed upon using the most recently available actuarial reports to support this expense claim. The agreed upon decrease is $491,000 and is properly reflected in the Company’s revised claim.

 **4. Postretirement Benefits other Than Pension**

 This is a corrected adjustment which is based upon the most recently available actuarial reports. The Company and the OCA have agreed upon the revised claim.

 **5. Interest Synchronization**

 **a. Positions of the Parties**

 This procedure synchronizes the interest deduction for tax purposes with the interest component of the return on rate base to be recovered from ratepayers. OCA witness Morgan determined the tax-deductible interest for ratemaking to be overstated by the Company and proposed a reduction to state and federal income taxes of $15,000 and $49,000 respectively. The Company did not object to this adjustment.

 **b. Disposition**

 The interest synchronization calculation is part of the final iteration process performed at the conclusion of the rate proceeding wherein all of the Commission allowed adjustments are reflected within the development of the ultimate revenue allowance.

 **K. OTS Additional Expense Adjustments**

 **1. Community Betterment Initiative**

 **a. Position of the Parties**

PPL proposes to establish a mandated ratepayer contribution of $1.0 million annually to its program designed to assist community development organizations and human service agencies in its service territory. If approved, PPL intends to match the ratepayer contribution dollar-for-dollar with a contribution from its shareholders.

 PPL’s proposal to be a good citizen is laudable; the shareholders’ contribution is generous. However, the use of ratepayer funds in this regard is not appropriate. The OTS states that, “In the present proceeding the Company has not demonstrated, with substantial evidence, that this program is any different than the programs offered in its last base rate case. They were identified as social programs in the past and this offering is no different. As a social program and absent proof of a demonstrable benefit to ratepayers, this claim must be rejected.” (OTS Exc. at 17).

 The OCA supports the Company’s proposal to mandate a contribution from ratepayers and believes that the CBI can provide benefits to ratepayers, particularly if the affordable housing component operates to leverage state funding to help implement energy efficiency investments in affordable housing. (OCA M.B. at 171; R.D. at 172). The CEO wants the program restructured to implement a formal review process of CBI fund allocations with input from all relevant stakeholders. The OTS and DOD object to any mandated ratepayer funding. DOD contends that ratepayers should make their own decisions regarding contributions to social or charitable contributions. The DOD also opines that the program should have a formal review process of the funding allocations with input from all relevant stakeholders. According to OTS, the Company is attempting to fund a social program through ratepayer funds and asserts that no direct benefit to customers has been established, therefore, the $1 million claim must be denied

 **b. ALJ Recommendation**

 The ALJ recommended allowance of the $1 million mandatory ratepayer contribution. (R.D. at 76).

 **c. Exceptions**

 OTS filed Exceptions to this finding of the ALJ. In its EXCEPTONS, the OTS again recommends that this expenditure be denied.

 **d. Disposition**

 The use of ratepayer funds in this regard is not appropriate because PPL has failed to provide concrete record evidence quantifying how the program will benefit ratepayers. Furthermore, in PPL’s prior base rate proceeding, the costs associated with these socio-economic type programs were not allowed. As such, we shall grant the Exceptions of the OTS, reversing the ALJ recommendation, and deny recovery of the $1 million mandatory ratepayer funded portion of this program. We do, however, encourage PPL to contribute corporate funds into the CBI.

 **2. Service Corporation Charges**

 **a. Positions of the Parties**

PPL has presented a claim of $130,000 within its Services for External Affairs expense. In response to OTS-RE-84, the Company captions this claim as rate case communications preparation, including survey research. In its Statement No. 2-R at 9, PPL agrees with OTS that this is a non-recurring expense but asserts that it is a normal rate case expenditure. PPL also explains in its Statement No. 2-R that, included within its estimated rate case expenses associated with this case, is the amount of $130,000 for external affairs expense.

 OTS suggests that this expense claim as included within the external affairs account should be rejected as being duplicative.

 **b. ALJ Recommendation**

 The ALJ agrees with OTS on this issue and recommends adoption of the OTS adjustment of $130,000. (R.D. at 77).

 **c. Disposition**

 We agree with the ALJ’s recommendation supporting the OTS’ adjustment removing a duplicative claim from the Company’s future test year expenses.

 **L. Sustainable Energy Fund**

 **1. Positions of the Parties**

PPL has proposed that the Commission allow continued funding of the SEF as part of its distribution rates at its current level of 0.01 cents per kWh from all customers for a period to end not later than December 31, 2009. (PPL Electric St. 7 at 24). Therefore, the Company includes $3,689,000 as a new cost of distribution service expense in the future test year.

Since January 1, 1999 to December 31, 2004, PPL has allocated .01 cent per kWh, on all power sold, from its Distribution rate revenue to fund the SEF. This allocation was established in the Company’s Restructuring Settlement Agreement. PPL recognizes that while the parties to the 1998 Settlement Agreement were able to reach agreement regarding SEF funding, *that consensus no longer exists*. (PPL St. 7-R at 34). The Company has characterized its proposal as a compromise position between the proposals of the parties who wish to increase the monies committed to SEF (PennFuture) and/or change its program (OSBA and CEO) and the proposals of parties who object to SEF funding and seek its elimination (OTS, PPLICA and USDOD). (R.D. at 79-80).

The purpose of the Fund is stated in the Company’s restructuring settlement as paragraph E.5 and states in part that:

The purpose of the fund is to promote the development and use of renewable energy and clean energy technologies, energy conservation and efficiency which promote clean energy.

*Application of Pennsylvania Power & Light Company*, Docket No. R-00973954, Joint Petition for Full Settlement (August 12, 1998).

 At least two parties have proposed terminating all funding for SEF on various grounds, including: (1) that it is unrelated to distribution service ( PPLICA St. 1-R, at 9-13); (2) that it is unrelated to distribution service, and it is a hidden tax (OTS St. 5 at 5); and (3) that it does not conform to certain federal criteria relating to life-cycle cost-effective conservation measures or is insufficiently funded (USDOD St. 2 at 7). OSBA has proposed turning over SEF management and funds to the Pennsylvania Energy Development Authority (PEDA). (OSBA St. 2 at 8).

 By contrast, PennFuture has proposed increasing SEF funding to 0.02 cents per kWh for power sold to all customers. (PennFuture St. 1 at 3). Also, CEO has proposed various program and management changes, including restricting a portion of SEF funds to photo-voltaic systems and specific customer classes. (CEO St. 2 at 16-19).

 As the Company has pointed out, agreement no longer exists as to the existence of SEF. OTS contends that PPL is actually violating the terms of the settlement by recommending that SEF continue. The ALJ disagrees. The agreement says that the “.01 cent per KWh shall not *automatically* be considered a cost of service element upon expiration [of the caps].” (R.D. at 77, *citing* Section E.5 of PPL Restructuring Settlement (emphasis added)). OTS also argues that there is no discernible benefit from SEF to distribution ratepayers, and states that it has no objection to SEF so long as ratepayers do not have to fund it. PPLICA also objects to its continued existence, or rather its continued funding by distribution ratepayers.

 The ALJ disagrees with those parties that contend that collection of money for SEF through rates is a tax. It is obviously not a hidden tax, because SEF is quite open and above board. The tax argument must be based on the transfer of ratepayer money to another enterprise, other than the utility itself for utility functions. However, SEF’s activities are of a kind that the Commission has encouraged utilities to perform, and they are designed to fit in with and accentuate utility functions.

 OSBA wants any new funding to be transferred to PEDA. OSBA takes no position on whether SEF should be funded by ratepayers beginning January 1, 2005. OSBA posits that PEDA could coordinate all the sustainable energy funds that were created across the state as part of the restructuring process of most utilities. (OSBA M.B. at 28). OSBA argues that PEDA control would assure that the money is spent in a manner consistent with statewide energy goals and that as a government agency, PEDA can be more readily accountable for its spending priorities and management practices than SEF. (OSBA M.B. at 28). OSBA is critical of SEF’s operations and achievements in its testimony and its Briefs.

 OSBA points out that SEF is supporting a large Somerset County wind farm project, across the state from PPLEU’s territory, and contends that it has relatively few biomass digesters, which could be useful in the rural areas of the Company’s territory. OSBA also asserts that SEF has a vague and unfocussed internal process for selecting projects, and varied geographic parameters. OSBA also avers that SEF is not spending the money that it has, that it has made questionable investments in the stock market, that its administrative expenses are high, and that there is uneven representation of interests on the board. (OSBA M.B. at 29-34). CEO would also like to see different representation on the Board.

 PPLICA argues that inclusion of SEF funding as an expense in the Company’s rates is unjust, unreasonable, and illegal. PPLICA argues that none of SEF’s projects have produced any demonstrable benefits for PPL ratepayers, thereby barring inclusion of SEF funding in rates. *(See Pennsylvania Public Utility Commission v. Pa. Power & Light Co.*, 85 Pa. P.U.C. 306, 338, 339-40 (1995) (explaining that Commission-sanctioned funding is not appropriate when there is no demonstrable benefit in light of cost to ratepayers) and *U. S. Steel Corp. v. Pennsylvania Public Utility Commission*, 390 A. 2d 849 (Pa. Cmwlth. Ct. 1978).

 PPLICA argues that those who are proponents of SEF funding have the burden of proof to demonstrate benefits from SEF’s projects, and clearly PPLICA includes SEF and PennFuture, under that burden. (PPLICA R.B. at 38, n. 4). The ALJ does not believe that this is legally correct. She believes that PPL retains the undivided burden of proof on this matter.

 **2. ALJ Recommendation**

 The ALJ recommended that the Commission approve the Company’s new cost of service distribution expense claim of $3,689,000 and suggests that consideration be given to establishing declining annual funding levels, so that at the end of five years funding will have ended. The ALJ found the record to be sufficient in regard to supporting benefit to ratepayers. At page 84 of the Recommended Decision, the ALJ lists several projects that had a direct benefit on some of PPL’s ratepayers. Additionally, the ALJ stated that there should be a place and a role for organizations like SEF in the new marketplace, to market efficiency and demand reductions to all EDCs. (R.D. at 87).

 **3. Exceptions**

The SEF stated in its Reply Exceptions that its energy conservation and demand management projects have undeniable distribution benefits. The reduction of customer load, or the shifting of that load to lower-peak periods, reduces the loading and stress on the distribution system, extending its life and ending or delaying the need for expensive distribution system upgrades. (SEF Exc. at 12). As an example of energy saved, SEF at page 14 of its Reply Exceptions stated that the advanced energy control system for Allentown Technology Center, an in-town business incubator, is saving 1,325,050 Kwhs per year of energy, and creating much needed jobs in a critical urban renewal zone.

 **4. Disposition**

 We believe that the examples of projects contained in the ALJ’s Recommended Decision and those explained in SEF’s Exceptions fully support that direct benefit to ratepayers is a tangible outcome of the efforts of the SEF’s activities.

 The SEF has helped to foster the development of alternate sources of energy and with the Pennsylvania’s **Alternative Energy Portfolio Standards Act (**Act 213) being signed into law on November 30, 2004 by Governor Edward G. Rendell, the SEF and Pennsylvania’s other regional funds will have an additional source of funding. Further, the SEF has effectively managed its funding and has a strong balance sheet, showing unrestricted net assets of $12,203,454 at June 30, 2003 and therefore is achieving a stated goal of this Commission, that the SEF itself become sustainable.

 Given the breakdown of the consensus, achieved at PPL’s restructuring settlement, the strong balance sheet of the SEF and the Legislature’s creation of a permanent statutory funding source, now is the appropriate time to begin eliminating the use of distribution revenues to support the SEF.

 While we agree with the ALJ’s rationale for approving the continued funding of the SEF at this time, we shall approve ratepayer funding for the SEF only through December 2006. The funding level to be included within distribution rates for 2005 and 2006 shall be 0.01 and 0.005 cents per kWh respectively.

**VII. TAXES**

 **A. Capital Stock Tax**

 **1. Positions of the Parties**

 The Company has proposed a Capital Stock Tax (CST) expense using the current rate of 6.99 mills instead of the 5.99 mills that has been established by Statute to go into effect on January 1, 2005. PPL proposed to use the higher rate because in the past, two other similar reductions to the CST rate have been eliminated by the General Assembly. The Company also suggested establishing a State Tax Adjustment Surcharge (STAS) to account for this difference should the General Assembly keep the statutory 5.99% to be effective on January 1, 2005. The Company’s total CST expense claim is $7,820,000. (R.D. at 89).

 The OTS and OCA presented adjustments to the Company’s CST expense claim. First, both the OTS and OCA agreed that the proper rate to employ in calculating the CST is 5.99%. Next, the OTS and OCA proposed adjustments to the historic net income figures used in the CST calculation. The OTS and the OCA removed Year 2000 net income from the computation because they state that for that year net income included revenues from the generation segment of the Company’s business. The OCA also removed Year 2001 net income for the same reason. The OTS and the OCA also have estimated net income, based upon PPL receiving the total requested increase for Year 2005, to be used in the CST calculation.

 The OTS further argued that the CST should not be included in the iteration process at the end of the proceeding because this tax does not directly track net income as does Gross Receipts Tax or Federal and State Income Taxes. The Company is not supportive of any adjustment to the historic net income figures used to calculate the CST and contends that the exclusion of Year 2000 and Year 2001 income data relating to the years in which the company owned generation operations and inclusion of Year 2005 income is contrary to the calculation used by the Pennsylvania Department of Revenue. (R.D. at 93).

  **2. ALJ Recommendation**

 The ALJ stated that the amount decided on should be forward looking, and should allow the Company to collect the revenues that it will need to pay the future CST, but should not be set at an unrealistically high level that would be unfair to ratepayers and recommends that the CST should be calculated using a five-year average of net income ending in Year 2005 and should also incorporate the statutory rate of 5.99%.

 The ALJ recommended adoption of the OTS adjustment for this issue reducing the Company claim of $7,820,000 by 1,269,000 ($808,000 for use of the proper tax rate and $5,743,000 for the elimination of 2000 net income and the addition of estimated 2005 net income) to an allowance of $6,551,000. (R.D. at 89 and 94).

 **3. Exceptions**

 The OCA excepted to the ALJ recommendation which adopted the OTS adjustment. The OCA believes that both Year 2000 and Year 2001 net income should be removed from the calculation of the CST because, it avers, both years contain net income from generation activities. Both the OCA and OTS have extended the CST formula computation years to include Year 2005, but the OTS removes only Year 2000 on the same basis as the OCA while maintaining the statutory five-year average net income component. The OCA does not maintain the five-year average net income component of the calculation and thus, should be denied.

 PPL also excepted to the ALJ recommendation, which adopts the OTS adjustment *methodology*. PPL has not excepted to the other CST recommendations of the ALJ. While the Company has excepted to the OTS *methodology*, that is, using Year 2005 as part of the five-year average net income to compute the CST, it does not object to the *amount* of the CST as presented by OTS.

 PPL explains in its Exceptions that the OTS *methodology* creates a disconnect between the CST calculation and the remainder of the rate case, which is based upon the FTY ending Year 2004 as adjusted for ratemaking purposes. The Company also characterizes the OTS *methodology* as procedurally improper and unprecedented because it would constitute a major abandonment of test year concepts that the Commission has applied for many years.

 PPL’s Reply Exceptions to this issue address only the OCA’s recommendation. OTS’ Reply Exceptions state that, given the Company’s agreement and being satisfied that the public interest is protected, OTS can accept the Company’s formula presented in its Exceptions for future calculations to the extent anomalies are adequately addresses.

 In its Reply Exceptions, OCA again addresses the proper tax rate to be employed and the inclusion of generation enterprise income for the Year 2001 tax year within the formula.

 **4. Disposition**

 We will deny the OCA Exceptions be denied. We find PPL’s exception regarding the OTS *methodology* to be meritorious. PPL did not object to the outcome of the OTS adjustment. For the reasons stated above, we shall adopt the outcome of the OTS adjustment and deny the Exceptions of the OCA on this issue.

**VIII. RATE OF RETURN**

**A. Capital Structure**

1. **Summary**

 The Capital Structure recommendations submitted by the Parties in this proceeding are summarized in the following table:

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **PPL (1)****(%)** | **OCA (2)****(%)** | **OTS (3)****(%)** |
| Short-term Debt | 0.00 | 0.00 | 0.00 |
| Long-term Debt | 51.30 | 51.59 | 51.30 |
| Preferred Stock | 1.83 | 1.85 | 1.83 |
| Common Equity | 46.87 | 46.56 | 46.87 |
| ***Total*** | ***100.00*** | ***100.00*** | ***100.00*** |

(1) PPL St. 9, Exh. PRM-1, Sch. 1.

(2) OCA St. 3, Sch. MIK-1 at 1.

(3) OTS St. 1, Exh. 1, Sch.1.

 **2. Positions of the Parties**

 PPL’s proposed capital structure reflects the estimated balances of long-term debt, preferred stock and common equity at the end of the future test year, December 31, 2004. The OTS accepted PPL’s proposed capital structure.

 The OCA argued that the common equity component of the capital structure be reduced from 46.87% to 46.56%. This adjustment removes PPL’s addition of $15 million to retained earnings at the future test year’s end. According to the OCA, the $15 million addition is inappropriate and contrary to PPL’s own cash flow statements which show that PPL’s retained earnings have declined over the past two years. The OCA’s reservations concerning the addition of $15 million to equity capital, center on the need to finance future construction projects out of earnings. (OCA M.B. at 48-49).

 PPL counters that the OCA did not make any examination of the expenses incurred during 2002 and 2003 to determine whether abnormal expenses were incurred which would cause PPL to retain less than $15 million in retained earnings (PPL M.B. at 74-75).

 **3. ALJ Recommendation**

The ALJ recommended adoption of the OCA proposed capital structure, reasoning that PPL will not be able to build up or retain the level of retained earnings that it is claiming. (R.D. at 100).

 **4. Exceptions**

 In its Exceptions, PPL rejoins that the evidence of record indicates that its retained earnings, net of $2 million in dividends, increased by $34 million in the first half of 2004, which would be more than enough to justify its position that retained earnings would increase by $15 million for the entire year.

 PPL contends that the ALJ did not understand its claim. Specifically, PPL contends that the ALJ concluded that the $15 million should not be added to the test year retained earnings balance because “PPL may not be able to build up or retain a high level of retained earnings in the future.” PPL rejoins that this contention was not made by any party. PPL continues that there is no evidence to suggest that its retained earnings will decline after 2004. (PPL Exc. at 11-12).

 The OCA rejoins that the ALJ correctly found that there is no historical precedent to this claim. The OCA argues further that 2004 retained earnings bear no relationship to retained earnings in 2005. (OCA Reply Exc. at 10-11).

 **5. Disposition**

 The resolution of this issue turns on a determination of whether PPL would be able to retain the $15 million of retained earning that it is projecting to add at the end of the future test year, December 31, 2004. Our review of the evidence of record leads us to adopt the capital structure recommended by PPL and accepted as reasonable by OTS. The difference in capital structure ratios is a PPL projection of an increase in retained earnings for the future test year of $15.071 million ($318.762 million - $303.691 million). We reject the contention that the estimate of retained earnings of $15.071 million in retained earnings is unattainable.

 PPL has demonstrated that for the first 6 months of 2004, its earnings available for common equity were $36 million, with dividend payments for that time period of $2 million for a net of $34 million for retained earnings. We find that it is reasonable to expect that PPL’s projected increase in retained earnings for 2004 of $15 million is attainable. The OCA’s arguments do not rise to a level that would persuade us otherwise, particularly in light of the 6-month data provided by PPL.

 Although the OCA’s proposed adjustment arises from its concerns regarding PPL’s need to finance future construction projects from earnings, the OCA’s testimony in support of its proposed equity return appears to fly in the face of this position. Specifically, the OCA proffered the following testimony in support of its 9.5% return on equity recommendation:

I agree that the ability to fund construction is important, and the Company’s cash flow appears adequate in that regard. The construction estimates cited by [PPL witness] Mr. Moul appear to be a slight reduction from PPL’s actual con­struction outlays in 2002 and 2003.

(OCA St. No. 3 at 21).

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Cash flow from operations adjusted for earnings of $17 million (i.e. 9.5 percent ROE) clearly is strong and can finance construction. Moreover, cash flow coverage appears to be more than sufficient to meet the 3.0 x to 3.1 xs, standard cited by Ms. Cannell. For example, the *pro forma* 2003 results, at a 9.5 percent R.O.E. would provide a cash flow coverage of nearly 4.0x.

(OCA St. No. 3 at 21).

 Additionally, we find that the projected increase in revenues resulting from the instant proceeding will contribute to PPL’s ability to retain an additional $15 million in earnings. Accordingly, we grant the Exceptions of PPL and reverse the finding and recommendation of the ALJ on this issue.

**B. Cost of Debt and Cost of Preferred Stock**

PPL’s proposed cost rate for preferred stock is 6.43 %. The long-term debt cost rate proposal is 6.19 %. (R.D. at 101, *citing* PPL Exh. PRM 1 at 1). No party contested these rates. The ALJ recommended that the Commission accept the rates proposed by PPL. (R.D. at 101). No Exceptions were filed to this issue. Finding the Recommendation of the ALJ to be reasonable, we adopt it without further comment.

**C.** **Cost of Common Equity**

 **1. Overview**

 Although there are various models used to estimate the cost of equity, the Commission favors the popular Discounted Cash Flow (DCF) Model. The DCF model assumes that the market price of a stock is the present value of the future benefits of holding that stock. These benefits are the future cash flows of holding the stock, i.e., the dividends paid and the proceeds from the ultimate sale of the stock. Because dollars received in the future are worth less than dollars received today, the cash flow must be “discounted” back to the present value at the investor’s rate of return.

 **2. Summary**

 The ALJ proffered the following table which summarizes the cost of common equity claims made, and methodologies used by the parties in this proceeding:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **DCF** | **Risk Premium****(RP)** | **Capital Asset Pricing Model****(CAPM)** | **Compar-able****Earnings** | **Reasonable****Range** | **Point****Recommendation** |
| **PPL** **(1)** | 10.69%(E) to 11.22%(NG) | 11.75%(E & NG) | 10.71% (E) to 11.22%(NG) | 14.25%  | 11.0% to 11.75% | 11.50% |
| **USDOD (2)** | 9.3% to 10.26% | 10.44% | 11.00% | None | 10.25% to 11.0% | 10.75% |
| **OCA (3)** | 8.5% to 9.5% | None | 9.1% to 10% | None | 8.5% to 9.5% | 9.5% |
| **OTS****(4)** | 8.76% to 9.07% | None | None | None | 8.75% to 9.0% | 9.0% |

(1)PPL Statement No. 9 (2) USDOD Statement No. 2 (3) OCA Statement No. 3 (4) OTS Statement No. 1

(E) Electric Company Barometer Group (NG) Natural Gas Company Barometer Group

 **3. Positions of the Parties**

 PPL applied four different market based models to two barometer groups; one consisting of electric companies and another consisting of natural gas companies to arrive at a common equity return claim of 11.50%. PPL’s electric barometer group consists of nine electric companies with the following common characteristics: (1) listed in the Electric Utility (East) Section of the *Value Line Investment Survey* (*Value Line*); (2) stock is traded on the New York Stock Exchange (NYSE); (3) operate in either the Northeastern or Southeastern region of the United States; (4) not currently the target of a takeover or acquisition; and (5) do not have a significant amount of unregulated electric generation. PPL’s gas barometer group consists of companies that have the following common characteristics: (1) listed in the Natural Gas Distribution Section of the *Value Line Investment Survey*; (2) listed on the NYSE; (3) operations in the Northeastern or Southeastern region of the United States; and (4) not currently the target of a takeover or acquisition. (PPL Statement No. 9 at 12-13)

 PPL was the only party to use a gas barometer group in this proceeding. PPL argued that it was necessary to use a gas utility barometer group to account for the element of circularity in the DCF method. Specifically, PPL argued that investors’ expectations depend on regulatory decisions. In turn, says PPL, regulators depend on investor expectations to make those decisions. (PPL M.B. at 76)

 For its electric company barometer group, PPL calculated a six-month average dividend yield of 4.61% adjusted to 4.75% for expected dividend growth. Then PPL added a growth rate of 5.5% based on analysts’ projections of earnings growth. This computation resulted in an unadjusted DCF rate of 10.25%. PPL then added a financial risk adjustment of 44 basis points (.44%) to adjust for what it states is an understatement of the allowed return on equity resulting from market prices exceeding book value of the barometer group. This calculation resulted in a risk adjusted DCF return of 10.69% for the electric company barometer group.

 For its gas company barometer group, PPL calculated a six-month average dividend yield of 4.18% unadjusted for expected dividend growth. Then, PPL added a growth rate of 6.25% based upon analysts’ projections of earnings growth. This computation resulted in an unadjusted DCF rate of 10.43%. PPL added a financial risk adjustment of 79 basis points (.79%) to the unadjusted DCF rate. This calculation resulted in a risk adjusted DCF return of 11.22% for the gas company barometer group. Thus, PPL’s DCF range, adjusted to reconcile the divergence between the market and book value of its common equity, is from 10.69% to 11.22%.

 For its Risk Premium (RP) computation, PPL used an average prospective yield of 7.25% on an A rated public utility bond based on *Blue Chip Financial Forecasts.* PPL then calculated the risk premium of 4.50% based upon the average risk premiums earned by the Standard and Poor’s (S&P) utilities’ stock over the utility bonds for the periods 1928-2003, and 1974-2003. Adding the prospective dividend yield to the risk premium yields results in an RP equity return of 11.75%.

 Since PPL’s equity cost range extends from the low end of the DCF range of 10.69% to the RP return of 11.75%, and the Capital Asset Pricing Model (CAPM) and Comparable Earnings returns fall within that range, PPL argued that an equity return well in excess of the 10.6% granted in the Commission’s most recent litigated case, *Pennsylvania Public Utility Commission v. Aqua Pennsylvania, Inc.*, Docket No.

R-00038805, (Order entered August 5, 2004) (*Aqua)*,[[8]](#footnote-8)is appropriate. Based upon the foregoing discussion PPL claims a return on equity of 11.50% in this proceeding.

 The USDOD applied the DCF, RP and CAPM methods to the same electric company barometer group used by PPL. For its DCF calculation, the USDOD arrived at a 12-month dividend yield of 4.51%. For the growth rate component, the USDOD eliminated one company, CH Energy Group, from consideration to calculate a range of growth rates from 4.6% to 5.5%. The USDOD then uses the growth rate range to arrive at an average expected dividend yield over the next twelve months. This, according to the USDOD, results in a DCF cost of equity range from 9.30% to 10.26%.

 The USDOD calculated an RP return of 10.44%. The calculation was based upon a dividend yield of 5.21% based upon the yield to maturity of 20-year treasury bonds. The risk premium of 5.23% was calculated using the income return series.

 The USDOD equity return recommendation of 10.75%, was computed by considering the average of the DCF, RP and CAPM returns which is 10.72%. The USDOD used the high side of the DCF analysis of 10.26% as the low side of its equity range. The CAPM result of 11.0% was considered the high side of the range. The USDOD urged that a return on equity not exceed the upper limits of this range. The USDOD opined that since the lower end of its reasonable range is the DCF calculation, the financial risk adjustment is unnecessary. (USDOD St. No. 2).

 The OCA’s electric company barometer group consisted of 8 companies,

7 of which also were included in the electric company barometer groups used by PPL and the USDOD. The common characteristics of the OCA’s barometer group were as follows: (1) inclusion in the *Value Line* Utility East data base; (2) primary operation as electric delivery service utility; and (3) operation in retail access states. (OCA St. No.

3 at 26).

 The OCA applied the DCF and the CAPM methods to its barometer group. For its DCF calculation, the OCA calculated a 6-month dividend yield of 4.86% adjusted for a half year dividend growth to 5.0%. For the growth component, the OCA used analysts’ earnings projections to arrive at a range between 3.5% and 4.5%. The OCA’s DCF recommendation was 9.5%, the upper end of its DCF range of 8.5 to 9.5%. The OCA chose the upper end of its range due to recent upward movements in interest rates. The OCA did not adjust its DCF result for financial risk. (OCA St. No. 3 at 30).

 The OCA used the CAPM method to test the reasonableness of its DCF calculation. The OCA’s CAPM calculation resulted in a range of 9.1% to 10.0%. The OCA commented that its CAPM result confirmed the reasonableness of its DCF calculation. The OCA’s cost of equity recommendation is 9.5% based on the foregoing calculations.

 The OTS was the only party in the proceeding to rely exclusively on an unadjusted DCF result for its equity cost recommendation. The OTS used two barometer groups: (1) a six-electric-company barometer group; and (2) a nine-company group which consisted of the companies in the group used by PPL and the USDOD, but excluded companies that did not have at least two sources of analysts’ forecasts of earnings growth. The OTS applied the DCF method to its two barometer groups and PPL.

 The OTS calculated dividend yields that were the average of spot yields as of May 21, 2004, and fifty-two-week average dividend yields. The average dividend yields, calculated by the OTS, were as follows: 5.02% for the six-company electric barometer group; 4.83% for the nine-company barometer group; and 4.05% for PPL. The OTS then averaged the growth rate estimates of several publications to arrive at growth rates of 3.9% for the six-company barometer group, 3.65% for the nine-company barometer group and 4.90% for PPL.

 The OTS calculations resulted in equity returns of 8.84% to 9.0% for the six company barometer group, 8.40% to 8.55 % for the nine-company barometer group and 8.84% to 9.06% for PPL. These calculations become the basis for the OTS DCF-based recommendation of 9.0% for the cost of common equity.

 **4. ALJ Recommendation**

 Based on her review, evaluation and analysis of the evidentiary record, the ALJ recommended adoption of USDOD’s DCF calculation of 10.25%. This result was not adjusted for financial risk. The ALJ opined that the Commission was not bound by its action in *Aqua* to consider different methods than DCF. Specifically, the ALJ states as follows:

The ALJ does not read *Pa American* and *Aqua Pa* to hold that the DCF result should be adjusted automatically and inclu­sively by the ALJ to a cost rate that one or more parties argue to be desirable and correct, or that the cost of equity should be a composite of the DCF and other methods such as R/P or CAPM.

(R.D. at 113).

 The ALJ found that adoption of USDOD’S DCF method and result seemed to include enough risk factors to reduce the disparity so as to produce a result that does not require a financial risk adjustment. (R.D. at 121).

 **5. Exceptions**

 In its Exceptions, PPL argues that the ALJ erred in using an unadjusted DCF return of 10.25%, which did not include a specific financial risk adjustment. PPL continues that the unadjusted USDOD recommendation of 10.25%, which the ALJ recommended, attempts to ameliorate the financial risk by recommending the higher end of its growth rate range. PPL argues that this approach does not adequately account for financial risk.

 PPL continues that in both *Aqua* and *PAWC,* the Commission allowed an equity return of 10.6%. PPL argues than in light of rising interest rates since the issuance of those previous rate orders, an equity return allowance of 10.25% is clearly inadequate. (PPL Exc. at 6-8).

 The OCA rejoined that its recommended equity return of 9.5% is adequate because it meets the expectations of the capital market. The OCA continued that its CAPM calculation confirms the reasonableness of its recommendation.

 The OCA labels the financial risk adjustment as unsupported. The OCA argues further that PPL overstated the difference between market and book capital structure, and that the comparison is different from that performed in *PAWC* or *Aqua.*

(OCA R.Exc. at 4-10). The OTS argues that the facts in *PAWC* and *Aqua* are distinguishable from those in the case before us and neither case can be relied upon for guidance in this matter. (OTS R.Exc. at 12-14).

 In its Exceptions the OCA argues that the ALJ erred in adopting the DCF recommendation of 10.25% of the USDOD. The OCA argues that the USDOD’s growth rate of 5.5% is inflated. Specifically, the OCA argues that both PPL and USDOD mistakenly use a 16% growth rate for PEPCO holdings. This figure, says the OCA, is anomalous because of PEPCO’s merger with Conectiv Energy (Conectiv) in August 2002.

 The OCA continues that the 16% growth rate is anomalous because *Value Line* included no dividend for the year 2001 for PEPCO, due to the impending merger with Conectiv, and this understated the dividend received by shareholders in 2002. The OCA submits that due to the *Value Line* calculation, the average growth rate should be 3.3% and not 5.5%. Thus, the OCA maintains that its equity return recommendation of 9.5% is appropriate. (OCA Exc. at 20-25). PPLICA, in its Exceptions, supported the OCA recommendations. (PPLICA Exc. at 12).

 PPL rejoins that a growth rate of 5.5% is not anomalous or overstated due to the *Value Line* calculation. PPL continues that a growth rate of 5.5% should be adopted as part of the DCF return. PPL argues that a recommendation on the high end of the growth rate range is reasonable due to high interest rates. PPL continues that the same *Value Line* projection, criticized by the OCA and the OTS, contained a dividend growth rate of (-4%) for Duquesne Light Company. PPL contends that it is the purpose of a barometer group to smooth out aberrations in data.

 PPL argues, as well, that the Commission should not rely on unadjusted DCF findings. PPL continues that the DCF calculations understate the cost of equity when market price exceeds book value. (PPL R.Exc. at 2-6).

 In its Exceptions, the OTS also discusses the data used by PPL and the USDOD to calculate the growth rate of 5.5%. The OTS also argued that the *Value Line* data and methods produced distorted results. (OTS Exc. at 23-24).

 PPL addressed this issue in its Replies to the OCA Exceptions. The discussion will not be repeated. We note, further, that although the USDOD was an active participant in this proceeding, particularly in the equity return deliberations, it did not file Exceptions.

 **6. Disposition**

 As noted previously, we have primarily relied upon the DCF methodology in arriving at our determination of the proper cost of common equity. The ALJ interpreted our previous actions in *PAWC* and *Aqua* as not compelling the use of other methods such as RP and CAPM to form an equity return based upon a composite of the DCF and other methods. We agree with the ALJ insofar as these prior actions do not compel the use of methods in addition to the DCF method. However, we conclude that methods other than the DCF can be used as a check upon the reasonableness of the DCF derived equity return calculation. We note that all of the parties in this proceeding with the exception of the OTS have done so. We will also use the results of the CAPM and RP methods as a check of the reasonableness of our DCF calculation.

 At the outset of our discussion, we agree with the ALJ’s determination that the use of a natural gas proxy group in this proceeding is inappropriate. Accordingly, we gave no consideration to the calculations resulting from its use. We reach this conclusion for several reasons.

 First, all of the parties in this proceeding were able to identify a base group of electric companies suitable for use as a proxy group. As previously noted, PPL and the USDOD used identical electric company barometer groups. We observe that the barometer groups used by the OCA and the OTS contain many of the same companies used by PPL and the USDOD, although individual companies were rejected by the witnesses for a variety of reasons. Therefore, we find that a sufficient base group of electric companies exists to create a reliable proxy group.

 Next, we find that PPL has not presented a persuasive argument to support its assertion that the use of a gas company barometer group eliminates a circularity problem defined as investors trying to determine what regulatory commissions will do while the regulatory commissions are trying to determine what investors will require. We find further that PPL’s Exceptions do not offer a convincing argument or evidence to refute the ALJ’s finding that use of a gas proxy group does not address the circularity problem it envisions, or that the circularity problems exist to the extent that PPL alleges.

 Finally, we find that PPL has not presented convincing evidence that the gas industry is sufficiently similar to the electric industry to be considered a reliable proxy. We find that PPL has failed to show the electric and natural gas industries are sufficiently similar that investors would expect the same equity return for both gas and electric companies.

 Based upon our analysis and review of the record evidence, the Recom­mended Decision and the Exceptions and Replies thereto, we reject the ALJ’s recommendation to adopt of the unadjusted DCF return of 10.25% calculated by the USDOD. Although we find the 10.25% figure to be a good starting point, it does not reflect the financial risk resulting from the divergence between the market and book value of PPL’s common equity.

 As discussed previously herein, PPL also calculated an unadjusted DCF equity return of 10.25% using the same electric company barometer group as the USDOD. After PPL added the adjustment of 44 basis points for financial risk, its DCF return increased to 10.69%.

 We recognize that the PPL estimate of an appropriate DCF growth rate of 5.5 % is at the high end of the array of growth rates offered by all parties of record. However, we conclude that the high end of the growth rate range is justified at this time due to the current uncertainties surrounding electric distribution companies.

 We agree with PPL’s Reply Exceptions that the *Value Line* growth rate calculations used by both the USDOD and PPL witnesses are not anomalous and can be relied upon in a calculation of a reasonable growth rate. PPL’s point is well taken that the purpose of a barometer group is to smooth out aberrations in data. We find no rational basis for ignoring the PEPCO growth rate of 16 % while considering the negative Duquesne growth rate of -4%.

 We also agree with PPL’s contention that it is appropriate to use the higher end of the growth rate range, in light of the fact that electric distribution companies are relatively new entities and there have been few rate allowances for such companies due to Transmission and Distribution (T&D) rate caps. We find it likely that current earnings projections reflect a conservative approach to future growth rates. In recognition of this depressing effect on DCF results, we agree that the 5.5 % growth rate as proposed by PPL, at the high end of the growth rate range, is appropriate at this time.

 We found that the dividend yield rate of 4.75 % as embodied in the PPL Electric Proxy Group DCF estimate is reasonable. This rate is within the range of dividend yield estimates offered by all parties of 4.75 % to 5.00%. This yield has been recommended by PPL and the USDOD witness and has been accepted by the ALJ in her recommended decision. The 4.75 % dividend yield represents a conservative estimate of those presented within the DCF analysis of the parties offering an equity return recommendation.

 We find it reasonable that a financial risk adjustment, as proposed by PPL, is necessary to compensate PPL for the mismatched application of a market based cost of common equity to a book value common equity ratio. The adjustment is necessary because the DCF method produces the investor required return based on the current market price, not the return on the book value capitalization.

 PPL has demonstrated that the market value of the equity in its Electric Company Proxy Group’s capitalization is much higher than its equity book value capitalization. At PPL Statement 9, Appendix E, PPL depicts the comparison of capital structure ratios based on market value and on book value:

 Electric Group

 Market Book

 Value Value

 % %

Long Term Debt 46.81 52.19

Preferred Stock 3.39 4.42

Common Equity 49.79 43.38

 100.00 100.00

 Book value equity capitalization (43.38%) is used for rate setting purposes whereas market based cost of equity estimates are derived from DCF analysis that reflects a different level of financial risk (49.79% common equity). This creates a mismatch between the financial risk on which the DCF return on equity capital is based and the financial risk embodied in rate setting (book value capitalization). This results as the capitalization of a utility measured at its market value contains relatively less debt than the capitalization measured at its book value when market price is above book value.

The capital structure ratios measured at the book value show more financial leverage (debt) and, therefore, higher risk than the capitalization measured at its market value. It is then necessary to adjust the market based DCF results to reflect the higher financial risk of the book value capital structure used for rate setting purposes.

 We note that the USDOD recognized that when market price exceeds book value, the constant growth DCF model is less reliable as growth in earnings, and dividends and book value are less likely to be equal under this circumstance. This is a key assumption of the constant growth DCF model. (USDOD Statement No. 2 at 14).

 We agree with the USDOD that investors purchasing stock at market prices greater than book value are at greater risk that the price will actually decline in the near future to approach book value, and increasing the risk that growth rates in earnings, dividends and book value will diverge from each other.

 Based upon the foregoing discussion, we conclude that a financial risk adjustment to the market derived DCF return of 10.25% for PPL’s Electric Company Proxy Group is appropriate at this time. This places the DCF return on a constant basis with the greater financial risk inherent in PPL’s book value derived capital structure ratios. Accordingly, we adopt the 45 basis point adjustment for increased financial risk offered by PPL as reasonable at this time.

 Those returns indicated by alternative, standard cost-estimation techniques provide additional measures so as to test the reasonableness of our DCF based cost of equity capital rate of 10.70% (10.25 + .45 for financial risk). The PPL CAPM study produces a 10.70% return rate for its Electric Company Proxy Group. A USDOD CAPM study estimates an appropriate equity return of 11.00%. The USDOD risk premium result is 10.44%. The OCA estimates a CAPM rate range of 9.0 to 10.0%. Additionally, PPL has presented a Risk Premium analysis that indicates an appropriate return on equity for its electric proxy group of 11.75%.

 Based upon the evidence of record, we find a range of reasonableness from 10.25% to 11.0%. We further find that within that range, a cost of common equity of 10.70 % is reasonable, appropriate and in accord with the record evidence. As such, we will use this figure for our determination of the cost of common equity in this proceeding.

 The following table summarizes our determinations concerning PPL’s capital structure, cost of debt, cost of preferred stock, and cost of common equity, as well as the resulting weighted costs and overall rate of return:

Capital Structure Ratio Cost Rate Weighted Cost

 % % %

Debt 51.30 6.43 3.30

Preferred Stock 1.83 6.19 .11

Common Equity 46.87 10.70 5.02

 100.00 8.43

 Accordingly, the Exceptions of PPL are granted to the extent consistent with the foregoing discussion, and otherwise denied. The Exceptions of the OCA, the OTS and PPLICA on this issue are denied.

**IX. RATE STRUCTURE**

 **A. Transmission Service Charge**

 PPL proposes to pass through a projected increase in transmission charges that it will incur for transmission services purchased from the Pennsylvania-New Jersey-Maryland Interconnection LLC (PJM.). PPL proposed that a Transmission Service Charge (TSC) be assessed on a per-kWh basis that will be reconcilable annually. Total transmission charges to PPL in the future test year are projected to be $198,973,679. (PPL Exh. DAK3). The projected increase over current charges is $57 million. (PPL St. 4 at 31). The TSC will not be applied to customers receiving transmission services from another provider. The initial TSC is proposed to be $0.00564/kWh, to be assessed uniformly across all rate classes. (PPL St. 4-R at 25).

No Party opposes PPL’s right to recover transmission charges in retail rates. The issues in the TSC are the proposed annual reconciliation and the allocation of the TSC among rate classes. (R.D. at 127).

1. **Reconciliation**

**a. Positions of the Parties**

The Company asserted that the transmission charge is an expense that is substantial, is subject to substantial variation, and that the variation is beyond the control of the utility. (PPL St. 4-R at 20). On that basis, the Company argues that reconciliation is appropriate. (R.D. at 129-130). The OCA and MAPSA supported the proposal. MAPSA supports annual reconciliation of the TSC as a means to reflect the actual transmission costs of PPL and ensure that recovery accurately reflects the costs. The OCA also supported reconciliation.

OTS opposed the TSC and argues that transmission charges are a known and measurable expense, they can be forecasted in the same manner as other expenses and should be treated as such. On that basis, the OTS asserts that there is no reason to make the TSC reconcilable. (OTS Exc. at 28). Similarly, the CCC objected to reconciliation on the basis that the charges are not volatile, automatic pass through eliminates incentives to control costs and increases in sales will offset some or all transmission-related costs. (CCC M.B. at 11).

**b. ALJ Recommendation**

The ALJ recommended approval of reconciliation of the TSC as proposed by the Company. (R.D. at 139).

**c. Exceptions**

Both the OTS and the CCC filed Exceptions to reconciliation of the TSC. The OTS again argues that transmission costs are known and measurable. As such, they can be forecast in the same manner as other expenses and do not need special treatment. (OTS Exc. at 26). The CCC also argues that the ALJ erred in recommending reconciliation. The CCC again argues that transmission charges are not volatile, that reconciliation eliminates incentives to control costs and that increased sales may offset some or all of the transmission related costs. (CCC Exc. at 2).

The Company responds that the record evidence supports its argument that the transmission expense is substantial, volatile and the volatility is beyond the Company’s ability to control. (PPL R.Exc. at 14). The Company notes that the 2005 projected transmission costs are approximately $200 million. The charges have varied substantially in the past. From 2000 to 2003, the transmission charges ranged from a low of $140 million to a high of $194 million. (*Id.*). Lastly, PPL points out that the charges are imposed under PJM’s Open Access Transmission Tariff, which is subject to review and approval by the Federal Energy Regulatory Commission. That tariff provides that transmission charges are allocated based upon peak and annual usage, a measure based upon customers’ usage which is outside the control of PPL. (PPL R.Exc. at 15).

**d. Disposition**

We will deny the Exceptions of the OTS and the CCC and adopt the recommendation of the ALJ that provides for reconciliation of PPL’s TSC. For the reasons discussed by the ALJ at pages 129 through 130 of the Recommended Decision and in PPL’s Reply Exceptions at Pages 14 and 15, reconciliation of the TSC is appropriate.

 **2. Transmission Service Charge Allocation**

 **a. Positions of the Parties**

 PPL proposed to assess the TSC on a uniform per-kWh basis across all rate schedules, with the initial TSC set at $0.00564/kWh. According to PPL, the uniform rate is an appropriate structure because (1) it is generally consistent with how PJM bills all load servers and (2) it permits calculation of a simple cent per kWh price to compare that can be used by customers to evaluate offers from Electric Generation Suppliers. (PPL St. 4 at 33-34). The OCA supported the Company’s proposal and argued that it accurately captures the nature of transmission service as it is provided in today’s unbundled environment. (R.D. at 133). The OCA also argued that the proposal met with PPL’s objective to restrict revenue increases to under 10% for each rate schedule on a total bill basis, effectively eliminated rate shock, incorporated the principle of gradualism and recognized the transitional period in which PPL operates. (*Id.* at 133). MAPSA also supported PPL’s proposal.

 The OSBA proposed to allocate each year’s TSC among rate classes based upon a five year average coincident peak and kWh usage. PPLICA proposed that TSCs would be allocated to each rate class based upon the PJM OATT methods and recovered from rate classes with interval metering based upon demand and energy cost elements. PPL also proposed two alternative methods. The first alternative allocated the TSC per rate class on a cost causation principle, but would be recovered on a uniform rate per kWh set within each rate class. PPL’s second alternative proposal would allocate the TSC among three broad customer categories with a different uniform TSC for each category. (R.D. at 137-139).

  **b. ALJ Recommendation**

The ALJ recommended adopting PPL’s initial proposal. She noted that the principal difference among the various proposals was the emphasis placed upon cost causation versus rate stability. The proposals weighted toward cost causation (PPLICA, OSBA, and PPL’s alternative proposals) provided more volatile TSCs while the converse holds for those concerned with rate stability. The ALJ found that PPL’s initial proposal provided gradual adjustments for the bulk of its ratepayers and that uniformity will be easier for customers to understand and for the Company to administer. (R.D. at 139).

**c. Exceptions**

The CCC and PPLICA argue that the proposed TSC design ignores cost causation principles. The CCC argues that PPL’s proposal fails to recognize that transmission charges are demand related, not energy related. The CCC also argues that a uniform charge further exacerbates cross subsidies among the various rate schedules. (CCC Exc. at 3-4).

PPLICA focuses its arguments on cost causation principles and the assertion that the PPL proposal will not move swiftly enough to eliminate the subsidy inherent in the transmission rate. (PPLICA Exc. at 12-22). PPLICA argues that its proposal is based on a cost-based allocation of transmission and ancillary service costs that tracks PPL’s own procedures to determine obligations for customers that access competitive generation supply. PPLICA asserts that this is the best methodology available at this time. (*Id.* at 13). PPLICA further argues that adoption of PPL’s proposal results in large customers bearing a disproportionate amount of the transmission increase. (*Id.* at 14).

PPLICA also argues that PPL’s proposal is inconsistent with the mandate of Section 2804(6) of the Code, 66 Pa. C.S. § 2804(6), which requires that PPL provide access to its transmission system at rates and terms consistent with PPL’s own use of the system. (PPLICA Exc. at 13). PPLICA states that its proposal adheres to cost causation principles and is an accurate application of PJM’s allocation methodology. Further, PPLICA states that its proposal does not force large customers to absorb a disproportionate portion of the Company’s overall transmission increase. (*Id.* at 17). PPLICA also argues that PPL’s proposal fails to promote competition and fails to encourage demand response measures among larger customers. (*Id.* at 21).

PPL responds and asserts that a cost of service study is only a guide in rate structure. PPL further states that cost of service allocations are “one of the most subjective elements of a rate case.” (PPL R. Exc. at 13). PPL notes that strict adherence to cost of service study results would shift recovery substantially to residential rate classes resulting in an additional $19.6 million allocated to those rate schedules. (*Id.*). PPL also states that its system can peak in summer in certain years and in winter in certain years. Accordingly, there can be substantial volatility in transmission charges if an allocation is designed using PJM’s methodology. PPL submits that its proposal avoids that significant volatility. (*Id.* at 14).

The OCA argues that the ALJ’s recommendation is presented in the context of the overall rate proceeding and is based on several factors, including rate stability, cost causation and customer understanding. (OCA R. Exc. at 17-18). The OCA asserts that: “Reviewing the proposed TSC in the context of the overall rate impacts that will result from this proceeding effectively reduces rate shock, incorporates the principle of gradualism and recognizes the transitional period in which PPL continues to operate. (*Id.* at 18).

**d.** **Disposition**

We will adopt the recommendation of the ALJ which recommends PPL’s initial proposal of a uniform TSC of $0.00564/kWh. In doing so, we note that PPLICA was persuasive in its arguments. However, we agree with the OCA that PPL is now in a transition to full competition. Accordingly, principles of gradualism, mitigation of rate shock and rate stability are extremely important. As PPL moves further along in its transition, it is possible that those principles will be more closely balanced and cost causation will move to the fore. However, based upon the record before us, we agree with the ALJ, PPL and the OCA that PPL’s initial proposal is the most reasonable TSC design at this point in time.

 **B. Distribution Revenue Increase Allocation**

 **1. Positions of the Parties**

 PPL proposed that rate changes for each rate schedule should be designed to move each rate schedule closer to the system average rate of return while limiting the overall increase for each schedule to no more than 10%. With the exception of rate schedules ISA and PRS, the increases range from 4.26% to 9.9% on a total revenue basis. Rate schedules ISA and PRS are allocated 0% increases on a total bill basis. A reduction in distribution revenues for rate schedules IS-T and LP-6 are planned. (R.D. at 145).

 The OCA disputed PPL’s cost of service study, but supported the Company’s allocation proposal on the basis that it recognizes principles of gradualism, avoidance of rate shock, and fundamental fairness. The OSBA, OTS, USDOD and PPLICA proposed different allocations, each designed to decrease the level of distribution charges allocated to a non-residential rate class. (R.D. at 150-151).

 **2. ALJ Recommendation**

 The ALJ determined that the Company’s allocation should be approved. With regard to PPL’s cost of service study, the ALJ stated “that cost of service studies are not regarded as fully accurate studies, and that their primary function is to allow the Commission to use them as a guide.” (R.D. at 144). She recommended that the Commission “rely primarily on the Company’s study for guidance.” (R.D. at 144).

 The ALJ discussed the difficulty in determining an appropriate distribution allocation during PPL’s transition to competition when the Company’s current rates reflect prior cost considerations. She quoted PPL witness Kleha with approval:

PPL Electric’s current rate structure is a product of the rate unbundling process which occurred in its electric restructuring proceeding. The unbundling of rates in that proceeding was based on the cost allocation study from PPL Electric’s 1995 base rate proceeding which reflects the company’s operation as a vertically integrated electric company. Thus, PPL Electric’s current rate structure contains vestiges of its prior vertical integration. The rate cap on PPL Electric’s transmission and distribution rates ends on December 31, 2004, but the cap on generation rates extends through 2009. It would be inappropriate, in my view, to undertake a major revision to PPL Electric’s cost allocation procedures in these circumstances. Any such review should await the expiration of the cap on generation rates.

(PPL St. 5-R at 3-4; quoted in the R.D. at 147-148).

 The ALJ opined that the correct issue was whether the revenue increase and rate design are “reasonable.” (R.D. at 151). In her view, the Company’s proposal produced fair results, meeting the requirement that the resulting “rate structure will not unduly burden one class of ratepayers to the benefit of another.” *Pennsylvania Public Utility Commission v. West Penn Power Company*, 73 Pa. P.U.C. 454, 510, 199 PUR 4th 110 (1990). The ALJ also noted the OCA’s position that the Company’s proposed allocation recognizes PPL’s transition while still moving rate schedules closer to the overall system rate of return. (R.D. at 148).

 **3. Exceptions**

PPLICA, the OSBA and the OTS each filed Exceptions to the ALJ’s determination of the revenue increase allocation. The OTS argues that the ALJ erred in approving the Company’s goal of limiting any rate increase to no more than 10% while failing to address substantial subsidies of the residential rate schedules. (OTS Exc. At

29-30). Likewise, PPLICA argues that PPL’s cost of service study reveals that large customers are paying distribution rates significantly above any reasonable measure of cost. (PPLICA Exc. at 26). PPLICA proposed its own rate allocation that it argues would address the subsidy issue while minimizing rate shock. (*Id.*). Under PPLICA’s proposal, there would be an immediate 50% subsidy reduction for any rate schedule currently subsidizing residential and street lighting rate schedules. After the first year, remaining subsidies would be reduced by 25% each year. (*Id.* at 27).

 The OSBA first argues that the ALJ’s acceptance of a 10% total bill increase limitation for each rate schedule is unsupported by the record and limits the opportunity to address the subsidies contained in the small business rate schedules. (OSBA Exc. at 13). The OSBA then argues that the Company’s proposal provides that rate schedules GS-1 and GS-3 are assigned increases greater than the system average, even though they are already over-paying their cost of service. (*Id.* at 17). According to the OSBA, that fact establishes that PPL’s proposed allocation produces discriminatory rates. (*Id.*). The OSBA proposes that a greater than system average increase should be assigned to rate classes currently under-paying their cost of service, to be capped at twice the system average on a total-bill basis. (OSBA Exc. at 20).

 PPL responds that its proposal is “consistent with the principles of gradualism in rate design and also with the fact that PPL Electric continues to be subject to generation rate caps and that a full reallocation and reconsideration of its rate structure cannot be undertaken at this time.” (PPL R.Exc. at 23).

 The OCA responds and argues that while the ALJ used the Company’s cost study as a guide, she also considered other factors including the OCA’s cost study, principles of gradualism and the fact that PPL is transitioning from bundled rates to unbundled rates. The OCA opines that the transition from unbundled rates is particularly important since it will take time to move rate classes closer to the overall system rate of return. Because other elements of service continue to reflect PPL’s former status as a vertically integrated utility, it is not possible to move as rapidly as the OSBA, the OTS and PPLICA propose. (OCA R.Exc. at 14-15).

 **4. Disposition**

 The ALJ is correct that cost studies are to be used as guides and not deemed to be an exact science. *West Penn Power*. Accordingly, while we look to cost of service studies for guidance, they are not the sole factor which determines appropriate rate increase allocations. We also agree with both PPL and the OCA that a 10% ceiling on rate schedule increases on a total bill basis is an appropriate methodology in this case to address the need to move rate schedules closer to the system average rate of return while recognizing the principles of gradualism and mitigation of rate shock.

 PPL summarized its position in its Reply Brief as follows:

PPL Electric’s proposal for revenue allocation reflects the Company’s understanding of this time of transition as well as a just and reasonable balancing of the diverse interests of its residential, industrial, and commercial customers. As explained in testimony and in PPL Electric’s Initial Brief, the Company established three key objectives for revenue allocation – a total bill increase on residential rate schedules of less than 10%, a total bill increase on all other rate schedules below 10%, and movement towards the system average rate of return for each customer class. PPL Electric Initial Brief, p. 166. Each of these objectives were achieved, *see id.*, and the resulting allocation should be approved by the Commission.

(PPL R.B. at 91).

 We do not here decide, as argued by PPL, that a full reallocation must await elimination of the generation rate cap. However, we agree with PPL and the OCA that the Company’s proposed revenue allocation in this case moves in the proper direction, albeit not as quickly as PPLICA, the OSBA and the OTS would wish. On the record before us, and for the reasons stated in PPL’s Reply Brief quoted above, we agree with the ALJ, PPL and the OCA that PPL’s proposed allocation is appropriate at this time and leads to a just and reasonable result. Accordingly, the Exceptions of PPLICA, the OSBA and the OTS are denied.

 **C. Rate Design – Increased Customer Charges**

 **1. Rate RS Rate Design**

 **a. Positions of the Parties**

PPL has presented a new rate design for Rate RS which includes 200 kWh of usage within the proposed $12.20 customer charge. The current customer charge for Rate RS is $6.55 and does not include a usage component. The Company’s proposed design also removes the first block, by including its usage within the customer charge, and bills for all usage above 200 kWh through a two-block tiered rate.

 Both the OTS and OCA disagree with PPL’s proposal to include 200 kWh of usage within the customer charge and with the approximate 86% increase in the charge from the current $6.55 to $12.20. OTS and OSA also testified that the current three-block design of Rate RS should remain intact.

* 1. **ALJ Recommendation**

The ALJ recommended adoption of the OCA’s customer charge of $8.00 and rejected the OTS proposal of $8.25 as well as the Company’s $12.20 stating that such a large increase cannot be justified. The ALJ also recommended maintaining the three-block rate design. No Exceptions were filed on this issue.

 We agree with the ALJ’s disposition of this issue. We believe it is sound regulatory practice to consider the magnitude of an increase in either the block rates or the customer charge when developing an appropriate rate design and gradualism plays an important role in this design. We found no compelling reason to subsume the first 200 kWh of usage within the customer charge as suggested by PPL and believe that the OCA’s recommendation for the customer charge properly reflected the concept of gradualism.

 **2. Rate RTS Rate Design**

 PPL has presented new rates for rate RTS. This rate is closed to new customers and only existing RTS customers receive grandfathered service for the life of their thermal storage equipment. PPL recommends an increase in the RTS customer charge, from $15.21 to $20.20 and a decrease in the single-block rate from $0.90 to $0.56. OTS agrees with PPL regarding the new customer charge of $20.20, but recommends that the block rate remain at $0.90. The OCA has recommended rejection of the proposed $20.20 customer charge because it captures too many costs that are not direct customer costs.

 The ALJ recommended adoption of the OCA position stating that it more accurately establishes a customer charge that comports with Commission policy, and all residential customers would receive the same ($1.45) customer charge increase in this proceeding. No Exceptions were filed on this issue

 We shall adopt the recommendation of the ALJ on this issue. The nature and amount of costs to be recovered through the customer charge must be closely monitored to insure not only that this fixed rate is not abused but also to assure gradualism in increased rate allowances.

 **D. Scaleback**

 **1. Positions of the Parties**

In the event that a lower increase than requested is approved, PPL and the OCA recommended that the proposed rates should be scaled back in a proportionate manner, by rate schedule. The CCC suggested that any scaleback should be used to further reduce rates for rate schedules paying amounts in excess of PPL’s over-all rate of return. The OTS and the OSBA also suggest that any scaleback in the requested increase be allocated in a manner that addresses rate schedules which are presently overpaying their cost of service. (R.D. at 148-149).

 **2. The ALJ Recommendation**

 The ALJ recommended adoption of the PPL proposal that any reduction be proportionately assigned to the various rate schedules. (R.D. at 148).

 **3. Exceptions**

The OSBA excepts to the recommendation that any reduction in the requested increase be proportionately assigned. The OSBA argues that the majority of PPL’s rate structure proposals directly benefit the residential classes at the expense of other customer classes. On that basis, the OSBA asserts that any reduction in the requested increase can be assigned to those classes which currently over-pay their cost of distribution service. (OSBA Exc. at 22).

 The OCA responds that because the Company’s proposed allocation is fair, there is no reason to change the proportionate increases to rates in a way that distorts that allocation. (OCA R.Exc. at 16).

 **4. Disposition**

As we discussed in our disposition of the Distribution Revenue Increase Allocation, we determined that the Company’s proposed allocation was appropriate. Since we determined that the proposed allocation is appropriate, we decline to depart from it on the record before us. Accordingly, a proportionate scaleback is the proper method to address any reduction in this case. The OSBA’s Exception on this issue is denied.

 **E. Traffic Lighting**

 **1. Positions of the Parties**

PPL provides traffic lighting service as a metered service under Rate Schedule GS-1. PLUG proposed that the tariff be changed to offer unmetered service for traffic signals, particularly for intersections with energy-efficient light emitting diodes (LEDs). PLUG asserted that traffic signal usage is consistent and ascertainable, accordingly, metering is unnecessary and imposes avoidable costs. (R.D. at 157). PLUG also argued that PPL should be required to subsidize conversion of traffic signals to LEDs through rebates and that PPL should offer a pilot program for unmetered rates. (PLUG MB at 17-18).

 PPL argued that traffic signal usage can be varied and complex. PPL also stated that there would be substantial administrative issues with unmetered traffic signal service as well as substantial costs. PPL further argued that metered service permitted municipalities that installed more efficient equipment to immediately benefit from reduced charges for service while unmetered service would not provide the same benefit. (R.D. at 158).

 **2. ALJ Recommendation**

The ALJ did not recommend adopting PLUG’s proposal for unmetered traffic signal service, but she did recommend that PPL be encouraged to “cooperate” with efforts to expand the use of LED traffic signals. (R.D. at 158).

 **3. Exceptions**

 In its Exceptions, PPL requests that the Commission clarify that no pilot program, unmetered service or rebates for traffic signal service has been directed. (PPL Exc. at 31-33). In its Exceptions, PLUG recommends that a working group be established to further explore a rebate program for LED traffic signals and the development of a non-measured LED traffic signal system tariff for a pilot program. (PLUG Exc. at 3).

 **4. Disposition**

 We will deny PLUG’s Exception and grant the Exception of PPL. We will not direct any pilot program at this time for the reasons expressed in PPL’s Exceptions at Pages 32 and 33. Simply put, under PPL’s metered service any municipality which installs LED traffic lighting will immediately experience savings based upon reduced usage.

 **F. Street Lighting**

 **1. Positions of the Parties**

PLUG argued that street lighting service should receive no increase at all or should receive a lesser increase on the basis that the service is a public good and because it is inherently interruptible (i.e., service was generally poor). (R.D. at 158-159). PPL responded that street lighting rates currently pay only a 1.6% rate of return, which is less than half of the average system rate of return. If PPL’s proposed increase is approved in full, the street lighting service would still be paying slightly less than one-third of the system average rate of return. PPL also contradicted PLUG’s argument that service was less than adequate. (*Id.*).

1. **ALJ Recommendation**

 The ALJ agreed with PLUG that street lighting was a public good, but recommended against adopting PLUG’s position, finding that the proposed increase was not too high “under the present circumstances.” (R.D. at 159).

 **3. Exceptions**

 PLUG reiterates its arguments that street lighting is a public good and the quality of service is more akin to interruptible loads. On those bases, PLUG argues that there should be no increase in rates or, alternatively, a lower increase than requested. (PLUG Exc. at 2-6).

 **4. Disposition**

We will deny PLUG’s Exception relating to street lighting and adopt the ALJ’s recommendation. While PLUG is correct that street lighting is a public good, we agree with the Company that street lighting service is not similar to interruptible service, nor does the record establish that PPL’s street lighting service is so inadequate as to warrant a reduction in the requested increase. The increase for street lighting comports with the Company’s goal of moving rate schedules closer to the system average rate of return while keeping any increase below 10% on a total bill basis. Accordingly, we will deny PLUG’s Exception.

 **G. Tariff Rule 5A**

 **1. Positions of the Parties**

 PPL proposed to change its existing Tariff Rule 5A “to clarify the customer’s responsibility beyond the point of delivery.” (PPL R.B. at 102). The current Tariff Rule 5A provides that the “customer assumes full responsibility for the energy and facilities beyond the point of delivery.” PPL proposes to add additional language that expressly notes that interruption of service can occur and cautions that it is the customer’s responsibility to purchase and install protective devices to protect the customer’s facilities and property. (PPL R.B. at 102). PPL asserts that the proposed change is merely a clarification and is not meant to alter the status quo. (PPL R.B. at 102-104). The proposed revision adds:

Interruption of service and variation in supply characteristics (including, but not limited to, high or low voltage, operation of protection or control devices, single phasing of three phase service, and phase reversal) can occur. To prevent or limit damage from such events it is the Customer’s responsibility to purchase and install protective devices and/or install or otherwise provide for alternate power supplies that are available from third parties to protect Customer’s facilities and property.

(PPLICA M.B. at 59).

 PPLICA objected to the proposed change to Tariff Rule 5A. According to PPLICA, the proposed change is, in fact, an effort to shift the onus of purchasing and installing protective devices and alternate power supplies to the customer to protect the customer’s facilities and property. PPLICA argues that the effect of the tariff change is to make the Company’s customers liable for damages arising out of any interruption or variation in PPL’s service. (PPLICA M.B. at 59-61).

 **2. Exceptions**

 PPLICA filed an Exception on this issue, noting that the ALJ did not address it in her Recommended Decision. PPLICA reiterates that the proposed tariff change is an effort to “unlawfully limit the Company’s duty to provide the quality of electric service required by the Public Utility Code.” (PPLICA Exc. at 28).

 PPL responds that its proposed changes “simply confirm other provisions of its existing Commission-approved tariff and are fully consistent with the Commission’s regulations and the Public Utility Code. *There is no change in policy or liability contemplated by this provision*, and it should be approved.” (PPL R. Exc. At

24-25 (emphasis added)).

 **3. Disposition**

 In the abstract, the concern raised by PPLICA is appropriate. However, upon review of the proposed revisions to Rule 5A and PPL’s position quoted above that they intend no change to policy or liability, it is appropriate to approve the change to Rule 5A as proposed by PPL. To address PPLICA’s concern, PPL shall be directed to explicitly state in Rule 5A that there is no change to the Company’s duty and responsibility to provide safe and adequate service.

**X. UNIVERSAL SERVICE and CUSTOMER/COMMUNITY PROGRAMS**

 **A. Introduction**

The Electricity Generation Customer Choice and Competition Act (Act)[[9]](#footnote-9) defines universal service as the policies, protections, and services that help low-income customers maintain their electric service. 66 Pa. C.S. § 2803. The Act provides that the Commonwealth must, at a minimum, continue the protections, policies and services that now assist customers who are low-income to afford electric service. 66 Pa. C.S. § 2802(10). The Commission must ensure that universal service is appropriately funded and available in each electric distribution territory. 66 Pa. C.S. § 2804(9). The Act mandates that universal service policies and activities are to be funded by nonbypassable, competitively-neutral cost-recovery mechanisms that fully recover the costs of universal service. *Id.*

The universal service programs offered by PPL include OnTrack, which is a customer assistance program (CAP); the Winter Relief Assistance Program (WRAP), a weatherization and energy conservation program; Customer Assistance Referral and Evaluation Services (CARES), a referral and evaluation program; and Operation HELP, a hardship fund derived from ratepayer, shareholder, and employee contributions. (PPL St. 7 at 5-6).

1. **OnTrack**
2. **Funding**

This issue is discussed at Section VI, I, 1 *supra*.

**2. $150 Arrearage Eligibility Requirement**

 **a. Positions of the Parties**

 One of the eligibility requirements for the OnTrack program is an overdue account balance of at least $150. (PPL St. 7-R at 16-17). PPL states that the measure was imposed to ensure that the limited resources of the OnTrack program are directly targeted to those customers who are most vulnerable to termination of service. (PPL M.B. at 139; Tr. at 729-730). The Company initiates collection efforts by way of a termination notice when a residential customer’s arrearage reaches $150. (PPL M.B. at 139; Tr. at 729-730).

CEO proposes that the practice of restricting participation in the program to customers with overdue balances of at least $150 be discontinued. (CEO M.B. at 14-15). CEO contends that it discriminates against low-income customers, particularly the elderly, who pay their electric bills in full, and may encourage outstanding balances to accrue. (CEO St. 1 at 8; CEO St. 2 at 12-13).

 **b. ALJ Recommendation**

ALJ Turner recommends that the Commission permit the Company to retain the $150 arrearage requirement to ensure that OnTrack resources are directed to those customers most at risk for termination. (R.D. at 168).

 **c. Exceptions**

 CEO filed Exceptions to the Recommended Decision and argues that the $150 arrearage requirement is inconsistent with the definition of a low-income payment-troubled customer at 52 Pa. Code § 54.72. (CEO Exc. at 8). In its Reply Exceptions, PPL argues that elimination of the $150 arrearage requirement, without additional funding to reflect the elimination of this requirement, would prevent CAP benefits from reaching those customers most at risk for termination of service. (PPL Reply Exc. at 21, n. 14).

**d. Disposition**

 We will grant the CEO’s Exceptions and reverse the ALJ’s recommendation on this issue. As a temporary measure, the Commission allowed PPL to impose the $150 eligibility requirement as well as the requirement that subsidized housing costs must be greater than $150. PPL was instructed that once funding was resolved, it was to revise its eligibility criteria to be consistent with the definition of a low- income, payment-troubled customer at 52 Pa. Code § 54.72. As this rate case resolves the Company’s funding issues, the $150 eligibility requirement as well as the $150 subsidized housing requirement must be eliminated consistent with our decision in *PPL’s Universal Service and Energy Conservation Plan Submission in Compliance with 52 Pa. Code § 54.74*, Docket No. M-00031698, entered June 13, 2003.

1. **Funding for WRAP**

This issue is discussed at Section VI, I, 2 *supra*.

**C. Mandatory or Proactive Budget Billing Program**

1. **Positions of the Parties**

The OCA avers that only a small portion of the PPL customers with significant arrears are on payment plans. (OCA St. 5 at 17). The OCA proposes that low-income customers who are in arrears, but not yet in a payment plan, be placed into mandatory budget billing each May. (OCA St. 5 at 14). The customer’s arrearage payments would equal the average payment required under the BCS informal payment plan guidelines for the income tier to which the customer belongs. (OCA St. 5 at 14). If the customer did not wish to be in the payment plan, they could contact the Company to negotiate an alternative plan. (OCA St. 5 at 14). The OCA proposes that the Company aid these customers in acquiring federal Earned Income Tax Credits (EITC), so that they are better able to pay their bills. (OCA St. 5-R at 9-10). The OCA wishes to participate in the process of designing and implementing the EITC program. (OCA R.B. at 63).

PPL opposes the OCA’s mandatory budget billing proposal and notes that it is already communicating with these customers regarding their arrearages. (Tr. at 716-717). PPL states that the OCA’s proposal is unlikely to reduce arrearages and is likely to increase costs, complaints, and cause customer dissatisfaction. (PPL R.B. at 79). PPL posits that for the typical residential heat customer, May’s actual bill is $45, whereas a budget bill would be $165, and if a portion of the arrearage is added, the bill would increase to a total of approximately $200. (PPL M.B. at 141). PPL has agreed to implement an EITC pilot program to assist its low-income customers in obtaining federal tax benefits. (PPL St. 7-R at 19; PPL M.B. at 141).

1. **ALJ Recommendation**

ALJ Turner rejected the OCA’s proposal, noting that “[t]he Company has employees in the trenches working with collections and payment-troubled customers and has some knowledge of what will work and what will not. There may be a need for a pro-active program, but this one is not it.” (R.D. at 170). No Exceptions or Replies were filed on this issue.

1. **Disposition**

The record does not indicate that customers unilaterally placed on budget billing would use EITC monies to pay their utility bills. As such, we will adopt the ALJ’s recommendation that the OCA’s proposal be rejected. We commend the Company for voluntarily implementing a pilot EITC program in an attempt to aid its payment troubled customers.

**D. Operation HELP’s Funding and Implementation**

**1. Positions of the Parties**

PPL’s Operation HELP pays for home energy bills using funds contributed by the Company, its customers, and employees. (PPL St. at 5-6). The estimated funding for Operation HELP in 2004 is $900,000. (PPL St. at 6). The program has raised $13.5 million to assist 52,000 customers since its inception. (PPL M.B. at 145; PPL St. 7-R at 28).

The OCA proposes that PPL be required to submit a plan to the Commission to demonstrate how it will increase Operation HELP contributions by 20%. (OCA St. 5 at 42). The OCA acknowledges that PPL cannot direct its shareholders to increase contributions to Operation HELP, but believes that the Company can fundraise more actively. (OCA St. 5 at 43). However, the OCA recommends that PPL increase Operation HELP shareholder contributions to Year 2001 levels and index the contributions so that they increase annually to reflect changes in the Consumer Price Index. (OCA St. 5 at 43).

The CEO proposes that Operation HELP funds should be distributed by county within PPL’s service territory based upon the number of low income customers in those counties. (CEO M.B. at 16; CEO St. 2 at 21).

**2. ALJ Recommendation**

ALJ Turner rejected the OCA and CEO proposals, based on the Commission’s lack of jurisdiction. (R.D. at 171).

**3. Exceptions**

The CEO, in its Exceptions, argues that the ALJ abused her discretion by allowing the Company to inequitably distribute Operation HELP funds throughout the Commonwealth. (CEO Exc. at 10-11).

The OCA, in its Exceptions, avers that the ALJ has confused the Commission’s lack of jurisdiction over contributions to the program with the Commission’s jurisdiction over PPL’s efforts in operating the program. (OCA Exc. at 26). The OCA argues that Operation HELP is an integral part of PPL’s universal service program, which, by law, PPL is required to adequately fund pursuant to 66 Pa. C.S. § 2408 (9). (OCA Exc. at 26).

PPL, in its Reply Exceptions, restates that Operation HELP is a voluntary program. (PPL Reply Exc. at 22).

**4. Disposition**

Operation HELP is wholly funded by contributions from the Company’s shareholders, customers, and employees. As such, we agree with the ALJ’s determination that the Commission lacks the jurisdiction to direct further contributions to Operation HELP or mandate the manner in which the Company chooses to distribute these contributions. The Exceptions filed by the CEO and OCA are denied.

**E. Community Betterment Initiative**

The Community Betterment Initiative is discussed in Section VI, K, *supra*.

**F. Request to Reallocate Universal Service Program Costs**

* 1. **Positions of the Parties**

The OCA seeks to have the Commission reallocate the costs for PPL’s universal service programs across all customer classes, instead of only to the residential classes. The OCA opines that because the universal service programs represent a public good, benefiting all customers, the program costs should be shared. (OCA M.B. at 174, 182). The OCA posits that the term “nonbypassable” contained in 66 Pa. C.S. § 2409(9) indicates that the General Assembly’s intent was to ensure that all customers making use of any part of the utility’s system should help pay for universal service costs. (OCA M.B. at 176).

PPL opposes the reallocation of universal service costs. PPL states that there is no legal basis for reallocation. (PPL M.B. at 152). PPL noted that the Commission previously rejected proposals to allocate universal service costs to rate classes other than residential customers to avoid cost shifting. (PPL R.B. at 81).

PPLICA opposes the OCA’s proposal. PPLICA opines that the term nonbypassable means that both shopping and non-shopping residential customers of generation supply should contribute towards universal service programs. (PPLICA St. 1R at 5).

The OSBA also opposes the OCA’s proposal. The OSBA states that the proposal for allocating universal service costs is not consistent with cost causation or sound regulatory economics principles. (OSBA St. 3 at 3). The OSBA opines that there is no credible basis for arguing that business customers cause PPL to incur universal service costs as only residential customers are eligible to participate in these programs. (OSBA St. 3 at 16).

Mr. Epstein proposes that PPL shareholders should be required to match ratepayer funding of the Company’s universal service programs. (Epstein at 23-24).

* 1. **ALJ Recommendation**

ALJ Turner recommended that the Commission reject the OCA’s proposal to reallocate the cost of universal service. (R.D. at 176).

* 1. **Exceptions**

The OCA filed Exceptions to the ALJ’s recommendation. The OCA submits that the concerns against changing cost allocations while rates are unbundled no longer serves as a bar to determining the proper allocation of universal costs under the Act. (OCA Exc. at 29). The OCA avers that the record contains ample evidence that universal service programs are a public good by law, and that they benefit all customers. (OCA Exc. at 29).

 Mr. Epstein, in his Exceptions, urges the Commission to reallocate universal service program costs around a shareholder cost-sharing formula. (Epstein Exc. at 24). Mr. Epstein states that funding for OnTrack and WRAP should reflect corporate gains. (Epstein Exc. at 20).

 PPL, PPLICA, and the OSBA filed Reply Exceptions restating their opposition to the OCA’s proposal that universal service program costs be reallocated amongst all customer classes. (PPL Reply Exc. at 22; PPLICA Reply Exc. at 8-9; OSBA Reply Exc. at 12-16).

* 1. **Disposition**

We will deny the Exceptions of the OCA and Mr. Epstein. Universal service programs, by their nature, are narrowly tailored to the residential customers and therefore, should be funded only by the residential class. We note that neither the OCA nor Mr. Epstein have presented any concrete evidence in the form of costs studies to support their respective proposals that the universal service program cost should be more broadly allocated. Accordingly, we will adopt the ALJ’s recommendation on this issue.

**XI. RETAIL COMPETITION ISSUES**

Strategic was the sole party to raise issues concerning retail competition. Strategic competes with PPL’s Provider Of Last Resort service and asserted that, to the extent that PPL’s distribution rates include the types of generation-related retail customer care and overhead costs that Strategic incurs in its competitive supply prices, its customers will pay PPL for costs they do not impose upon PPL. (R.D. at 176). Strategic averred that PPL’s distribution rates collect generation-related costs associated with uncollectible accounts, customer care and overhead, but cannot quantify them. If these costs cannot be extracted from PPL’s distribution rates, Strategic recommended that the Commission establish a Competitive Retail Customer Credit (CRCC), similar to what has been developed in New York. PPL responded that this would violate the bases of the Joint Settlement Agreement in its Restructuring case and the rate caps established there.

 Strategic asked that PPL specifically: (1) accelerate its AMR deployment; (2) provide electric generation suppliers (EGSs) with an updated Eligible Customer List and distribute related “opt-out” cards to customers; (3) accept an EGS’s telephonic representation that a customer has authorized release of customer information; and (4) provide EGSs with consolidated billing.

 The ALJ rejected each of Strategic’s proposals based upon PPL’s responses presented in rebuttal testimony. No Exceptions have been filed regarding this issue. We have no intention of revisiting PPL’s Restructuring Settlement and adopt the ALJ’s recommendation, without further comment.

**XII. PUBLIC INPUT HEARINGS**

 A total of nine public input hearings were held between June 28, 2004, and August 13, 2004, in locations throughout PPL Electric’s service area: Lancaster; Harrisburg; Bethlehem; Allentown; Scranton; Wilkes-Barre; and Williamsport. The ALJ, the OTS, the OCA, the OSBA, and the Company attended each hearing.[[10]](#footnote-10)

 The ALJ noted that although attendance was not high, valuable information was obtained at the hearings and individual complainants were given the opportunity to be heard on their complaints. (R.D. at 180).

 The Northeast Delegation, chaired by the Honorable Representative Phyllis Mundy, had its statement read into the record by its executive director at the Wilkes- Barre session.[[11]](#footnote-11) In Scranton, a representative of the Northeast Democratic Delegation of the House of Representatives testified that the amount of the increase was excessive, and opposed implementation of the DSIC. (R.D. at 180-181). In Williamsport, a Lycoming County Commissioner spoke positively of the Company, but opposed the increase, noting that it would have a dampening effect on development, and thus add to unemployment. (R.D. at 181). In Harrisburg, a representative of the Borough of Mechanicsburg stated that the Borough has had to pass on substantial costs to its citizens in the past two years, and asked that the Company receive a smaller or no increase at all. (R.D. at 181).

 The ALJ noted that members of the Pennsylvania Food Merchants Association appeared and testified in Lancaster and Bethlehem regarding how the increase would impact their business.[[12]](#footnote-12) (R.D. at 181). These individuals own and operate, or in one case, work for an ice cream manufacturer which must maintain refrigeration twenty-four hours a day, and lighting for long hours. (R.D. at 181).

 Members of the minority community in Harrisburg testified about the desire for more employment opportunities at PPL. (R.D. at 181). A number of retired persons opined that the 8% increase was too high, and should be reduced to 2.71%, or eliminated altogether. (R.D. at 181). Several people testified to the effects of Hurricane Isabel, and the length of time it took to get service restored. Specifically, a firefighter in Harrisburg testified that the Company’s response time to calls regarding dangerous conditions caused by the hurricane was delayed. (R.D. at 182).

 In Williamsport, one witness noticed that the Company’s original notice included in bills gave an incorrect cut off date for the filing of complaints. (R.D. at 181-182). The notice included the effective date for the rates, January 1, 2005. ALJ Turner found that while this is technically incorrect under the Regulations, nonetheless, the Commission does not have a cut off date for the filing of complaints in rate cases, and it is better to have a notice that is too permissive than one that improperly cuts people off. (R.D. at 182). As such, the ALJ denied the request to re-publish notice of the case reasoning that coming as it did in August, the request was impractical and would have created confusion had it been carried out. [[13]](#footnote-13)

**XIII. CONCLUSION**

 For the reasons discussed above, we will adopt the Recommended Decision of Administrative Law Judge Allison K. Turner as modified by, and consistent with the foregoing Opinion and Order; **THEREFORE,**

 **IT IS ORDERED:**

 1. That the Exceptions of the Citizens for Pennsylvania’s Future, Commercial Customer Consortium, Eric Joseph Epstein, Office of Consumer Advocate, Office of Small Business Advocate, PPL Industrial Customer Alliance, PPL Public Lighting User Group, and Sustainable Energy Fund of Central Eastern Pennsylvania are denied, consistent with this Opinion and Order.

 2. That the Exceptions of the Commission on Economic Opportunity, Office of Trial Staff, and PPL Electric Utilities Corporation are granted in part, and denied in part, consistent with this Opinion and Order.

3. That the Recommended Decision of Administrative Law Judge Allison K. Turner is adopted as modified by this Opinion and Order.

4. That the Complaints docketed at R-00049255C0001 to R-00049255C0020 are hereby granted or denied to the extent consistent with this Opinion and Order and shall be marked closed.

 5. That the Petitions to Intervene filed by the International Brotherhood of Electrical Workers, Local 1600; West Penn Power Company d/b/a Allegheny Power; and PECO Energy Company are hereby dismissed.

6. That PPL Electric Utilities Corporation shall not place into effect the rules, rates and regulations contained in Supplement 38 to Tariff Electric-Pa. P. U. C. No. 201, the same having been found to be unjust and unreasonable and therefore, unlawful.

7. That PPL Electric Utilities Corporation is hereby authorized to file tariffs, tariff supplements or tariff revisions containing rates, rules and regulations, consistent with this Opinion and Order, to produce annual operating distribution system revenues not exceeding $661,385,219 on a Pennsylvania jurisdictional basis.

8. That PPL Electric Utilities Corporation is authorized to establish a Transmission Service Charge, and the Transmission Service Charge rate shall be initially set at $0.00564 per kWh for services as set forth in the tariff, and shall be applicable to transmission services purchased by PPL Electric Utilities Corporation from PJM under the OATT to provide service to its POLR customers and others requiring the service.

9. That assessment of interest on Transmission Service Charge overcollections and undercollections shall be calculated at the statutory rate provided for in 66 Pa. C.S. § 1308.

10. That PPL Electric Utilities Corporation shall modify its proposed Tariff Rule 5A consistent with this Opinion and Order.

11. That PPL shall continue funding the Sustainable Energy Fund as part of its distribution rates at its current level of 0.01 cents per kWh from all customers through December 31, 2005, and thereafter, at the rate of 0.005 cents per kWh until December 31, 2006. At that time, the funding of the Sustainable Energy Fund through distribution rates shall cease.

12. That if a subsequent base rate case has not been concluded on or before December 31, 2006, PPL Electric Utilities shall institute a negative State Tax Adjustment Surcharge designed to exclude funding from the Sustainable Energy Fund as provided above.

13. That consistent with the Commission Order in *PPL’s Universal Service and Energy Conservation Plan Submission in Compliance with 52 Pa. Code § 54.74*, Docket No. M-00031698, entered June 13, 2003, PPL Electric Utilities shall revise the eligibility criteria of its Customer Assistance Program, OnTrack, to be consistent with the definition of a low income payment troubled customer at 52 Pa. Code § 54.72.

14. That consistent with Ordering Paragraph 13 above, PPL shall remove the $150 arrearage and the $150 subsidized housing criterion currently required for OnTrack eligibility.

15. That PPL Electric Utilities Corporation tariffs, tariff supplements and/or tariff revisions may be filed on less than statutory notice, and pursuant to the provisions of 52 Pa. Code §§ 53.1, *et seq*., and 53.101, may be filed to be effective for service rendered on and after January 1, 2005.

16. That PPL Electric Utilities Corporation shall file detailed calculations with its tariff filing, which shall demonstrate to the Commission’s satisfaction that the filed tariffs and adjustments comply with the provisions of this Opinion and Order.

17. That PPL Electric Utilities Corporation shall allocate the authorized increase in operating revenue to each customer class and rate schedule in the manner prescribed in this Opinion and Order.

18. That PPL Electric Utilities Corporation shall not include language in its tariff that establishes a Distribution System Improvement Clause.

19. That PPL Electric Utilities Corporation shall comply with all directives, conclusions, and recommendations contained in the body of the ALJ Recommended Decision, which are not the subject of an individual directive in these ordering paragraphs, as fully as if they were the subject of a specific ordering paragraph.

20. That, upon Commission approval of the tariffs filed in compliance with this Opinion and Order, these proceedings at R-00049255 shall be marked closed.

**BY THE COMMISSION,**

 James J. McNulty

 Secretary

(SEAL)

# ORDER ADOPTED: December 2, 2004

ORDER ENTERED: December 22, 2004

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| **TABLE I** |
| **PUC JURISDICITONAL** |
| **INCOME SUMMARY** |
| **Docket No. R-00049255** |
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|  | Pro Forma atPresent Rates |  | CompanyAdjustments |  | Jurisdictional Pro Forma atPresent Rates |  | CommissionAdjustments |  | CommissionPro Forma atPresentDistributionRevenues |  | CommissionDistributionRevenueIncrease |  | TotalAllowableAnnualDistributionRevenues |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Operating Revenue | $523,544,000  |  | $0  |  | $523,544,000  |  | $739,452  |  | $524,283,452  |  | $137,101,767  |  | $661,385,219  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  O & M Expense | 306,991,000  |  | 0  |  | 306,991,000  |  | (7,566,750) |  | 299,424,250  |  | 898,017  |  | 300,322,267  |
|  Depreciation/Amortization | 93,464,000  |  | 0  |  | 93,464,000  |  | 0  |  | 93,464,000  |  | 0  |  | 93,464,000  |
|  Taxes, Other | 44,608,000  |  | 0  |  | 44,608,000  |  | (1,224,340) |  | 43,383,660  |  | 7,894,017  |  | 51,277,677  |
|  Income Taxes: |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  State | 165,000  |  | 0  |  | 165,000  |  | 961,625  |  | 1,126,625  |  | 12,818,142  |  | 13,944,767  |
|  Federal | (24,446,000) |  | 0  |  | (24,446,000) |  | 3,032,487  |  | (21,413,513) |  | 40,422,057  |  | 19,008,544  |
|  Deferred | 30,425,000  |  | 0  |  | 30,425,000  |  | 0  |  | 30,425,000  |  | 0  |  | 30,425,000  |
|  Investment Tax Credit | (1,913,000) |  | 0  |  | (1,913,000) |  | 0  |  | (1,913,000) |  | 0  |  | (1,913,000) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total Expenses | 449,294,000  |  | 0  |  | 449,294,000  |  | (4,796,978) |  | 444,497,022  |  | 62,032,233  |  | 506,529,255  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net Income Available for Return | $74,250,000  |  | $0  |  | $74,250,000  |  | $5,536,430  |  | $79,786,430  |  | $75,069,535  |  | $154,855,965  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Rate Base | $1,837,003,000  |  | $0  |  | $1,837,003,000  |  | ($40,189) |  | $1,836,962,811  |  |  |  | $1,836,962,811  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Rate of Return | 4.04% |  |  |  | 4.04% |  |  |  | 4.34% |  |  |  | 8.43% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
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| **PPL Electric Utilities Corporation** |
| **TABLE IA** |
|  |  |  |  |  |  |  |  |  |  |  |
| **TOTAL OPERATING REVENUE SUMMARY** |
| **Docket No. R-00049255** |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |   |  | Company |  |  | Commission |
|  |  | Present Rate |  | Rate Revenue |  | Proposed Rate |  | Rate Revenue |  | Allowed Rate |
|  |  | Revenue |  | Change |  | Revenue |  | Change |  | Revenue |
|  | Distribution Present Rate Revenue | $525,272,624  |  |  |  |  |  |  |  |  |
|  | Distribution EDI/IDI Credit | ($2,049,786) |  |  |  |  |  |  |  |  |
|  | Transmission Present Rate Revenue  | $158,525,989  |  |  |  |  |  |  |  |  |
|  | CTC Present Rate Revenue | $84,832,104  |  |  |  |  |  |  |  |  |
|  | ITC Present rate Revenue  | $381,566,276  |  |  |  |  |  |  |  |  |
|  | E&C Present Rate Revenue  | $1,577,076,874  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | Present Rate Revenue  | $2,725,224,081  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | Change in Transmission Rate Revenue |  |  | $57,334,931  |  |  |  | $57,334,931  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | Jurisdictional Rate Increase  |  |  | $164,436,766  |  |  |  | $137,101,767  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | Total Revenue Increase  |  |  | $221,771,697  |  |  |  | $194,436,698  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | Total Proposed Revenue |  |  |  |  | $2,946,995,778  |  |  |  | $2,919,660,779  |
|  |  |  |  |  |  |  |  |  |  |  |
|  | Percent Increase  |  |  |  |  | 8.14% |  |  |  | 7.13% |
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|  | **Note:** This table is to illustrate the overall increase in total operating revenue granted to PPL compared to its initial request.  |
|  | The table is based on PPL Electric's final accounting exhibit, but does not include a revision to the amount of the proposed increase shown on page 1 of the Company's Main Brief. |  |
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| **PPL Electric Utilities Corporation** |
| **TABLE II** |
| **PUC JURISDICTIONAL** |
| **SUMMARY OF ADJUSTMENTS** |
| **Docket No. R-00049255** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  | State |  | Federal |
| Adjustments | Rate Base |  | Revenues |  | Expenses |  | Depreciation | Taxes-Other | Income Tax |  | Income Tax |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| RATE BASE: |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  Cash Working Capital: |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  Interest & Dividends  | ($24,449) |  |  |  |  |  |  |  |  |  |  |  |  |
|  Taxes  | 116,037  |  |  |  |  |  |  |  |  |  |  |  |  |
|  O & M  | (131,777) |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| REVENUES: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Late Payment Fees |  |  | $739,452  |  |  |  |  |  | $44,660  |  | $69,410  |  | $218,884  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| O&M EXPENSES: |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Hurricane Isabel |  |  |  |  | ($1,850,500) |  |  |  |  |  | 184,865  |  | 582,972  |
| Employee Severance  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  resulting from AMR program |  |  |  | (1,764,000) |  |  |  |  |  | 176,224  |  | 555,722  |
| WRAP/OnTrack |  |  |  |  | (1,900,000) |  |  |  |  |  | 189,810  |  | 598,567  |
| Service Corp. Charges |  |  |  |  | (130,000) |  |  |  |  |  | 12,987  |  | 40,955  |
| Community Betterment Initiative |  |  |  | (1,000,000) |  |  |  |  |  | 99,900  |  | 315,035  |
| Sustainable Energy Fund |  |  |  |  | (922,250) |  |  |  |  |  | 92,133  |  | 290,541  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| TAXES: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Capital Stock Tax |  |  |  |  |  |  |  |  | (1,269,000) |  | 126,773  |  | 399,779  |
| Interest Synchronization |  |  |  |  |  |  |  |  |  |  | 9,523  |  | 30,032  |
|   |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| TOTAL | ($40,189) |  | $739,452  |  | ($7,566,750) |  | $0  |  | ($1,224,340) |  | $961,625  |  | $3,032,487  |

1. During the course of the proceeding, PPL agreed to certain adjustments raised by other Parties, resulting in a reduction of its requested distribution rate increase from $164.4 million to $159.4 million. These adjustments are reflected in the Company’s final accounting Exhibit Future 1 (Rev). [↑](#footnote-ref-1)
2. The transmission charges arise under Federal Energy Regulatory Commission (FERC) regulated PJM Open Access Transmission Tariffs (OATT). [↑](#footnote-ref-2)
3. *ARIPPA v. Pennsylvania Public Utility Commission*, 792 A.2d 636 (Pa. Cmwlth. Ct. 2002) (*ARIPPA*). [↑](#footnote-ref-3)
4. As discussed *infra,* recovery of PPL’s AMR severance packages was disallowed for other reasons. [↑](#footnote-ref-4)
5. PPL argued against lengthening the amortization period because any extension reduces the total amount recovered, on a present value basis. (PPL St. 4-R at 39). [↑](#footnote-ref-5)
6. At year end 2003, there were 12,420 customers enrolled in the program. (PPL St. 7 at 8). PPL will spend approximately $11.7 million on the program in 2004. (PPL St. 7 at 6). [↑](#footnote-ref-6)
7. Year 2005: $6.0 M; Year 2006: $6.5 M; Year 2007 $6.7 M; Year 2008: $7.0 M; Year 2009: $6.9 M; Year 2010: $6.9 M; and Year 2011: $6.7M. (PPL St. 7 at 12). [↑](#footnote-ref-7)
8. *See also,* *Pennsylvania Public Utility Commission v. Pennsylvania-American Water Company,* docketed at R-00016339 (Order entered January 16, 2004.) *(PAWC)*. [↑](#footnote-ref-8)
9. 66 Pa. C.S. §§ 2801-2812. [↑](#footnote-ref-9)
10. OCA summarized each witness’s testimony at each public input hearing, with the exception of the last session in Harrisburg, without comment. (OCA M.B., Vol. II, Attachment D). [↑](#footnote-ref-10)
11. The relevant testimony begins on page 250 of the transcript. [↑](#footnote-ref-11)
12. These witnesses were represented by OSBA, and would be the beneficiary of its suggestions to reallocate the rate increase. [↑](#footnote-ref-12)
13. Section 1.2(a) of the Commission’s Regulations provides that, “[t]his subpart shall be liberally construed to secure the just, speedy and inexpensive determination of every action or proceeding to which it is applicable. The Commission or presiding officer at any stage of an action or proceeding may disregard an error or defect of procedure which does not affect the substantive rights of the parties. 52 Pa. Code § 1.2(a). [↑](#footnote-ref-13)