

Statement A

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

v.

PENNSYLVANIA POWER COMPANY

Docket Nos. R-2014-2428744

M-2013-2341993

**STATEMENT OF PENNSYLVANIA POWER COMPANY
IN SUPPORT OF THE JOINT PETITION FOR
PARTIAL SETTLEMENT OF RATE INVESTIGATION**

February 3, 2015

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**TO THE HONORABLE DENNIS J. BUCKLEY AND KATRINA L. DUNDERDALE,
ADMINISTRATIVE LAW JUDGES:**

I. INTRODUCTION AND OVERVIEW

Pennsylvania Power Company (“Penn Power” or the “Company”) submits this Statement in Support with respect to the Joint Petition for Partial Settlement of Rate Investigation (“Joint Petition”) entered into by and among the following Joint Petitioners¹:

Bureau of Investigation and Enforcement (“I&E”);

Office of Consumer Advocate (“OCA”);

Office of Small Business Advocate (“OSBA”);

¹ Noble Americas Energy Solution LLC (“Noble Americas”) does not oppose the Settlement. The Pennsylvania State University (“PSU”) and the Coalition for Affordable Utility Services and Energy (“CAUSE-PA”) have not signed the Joint Petition because they did not participate actively, through the submission of testimony or other evidence, in this proceeding. However, they both have submitted letters of non-opposition and support for the Settlement, which are appended to this Joint Petition, expressing their views that the Settlement is in the public interest. Citizens for Pennsylvania’s Future (“PennFuture”) does not join in the Settlement based upon the sole issue of PennFuture’s disagreement with Penn Power’s proposed rate for light-emitting diode (“LED”) lighting.

Penn Power Users Group (“PPUG”);

Environmental Defense Fund (“EDF”);

Wal-Mart Stores East, LP and Sam’s East, Inc.
(collectively, “Wal-Mart”); and

International Brotherhood of Electrical Workers Local
777 (“IBEW”).

If the settlement set forth in the Joint Petition (“Settlement”) is approved, it will resolve all issues in this proceeding except for the narrow and limited issues raised by PennFuture concerning the scope and pricing of Penn Power’s proposal to offer LED lighting service. These issues have been reserved for briefing. As will be explained in Penn Power’s Main Brief, PennFuture’s disagreement with the Company’s LED service offering lacks merit and, in any event, PennFuture has not proposed an alternative rate or alternative terms of service that could be considered for adoption in this case.

The Settlement of this case was achieved only after a comprehensive investigation of Penn Power’s operations and finances which included: (1) extensive discovery (Penn Power responded to 854 interrogatories); (2) submission of direct, rebuttal, surrebuttal and supplemental testimony covering a wide range of issues; (3) informal discovery; (4) public input hearings; and (4) negotiations among the Joint Petitioners as to the appropriate revenue level, rate structure, rate design, and other matters, including metrics for reliability, meter reading and customer service, as set forth in detail in the Joint Petition.

The Settlement has been achieved among parties representing a wide array of stakeholder interests, including residential, commercial and industrial customers; an environmental advocacy group; and a labor union that represents employees of the Company. The fact that the Settlement was reached among parties displaying the diverse interests of the Joint Petitioners is, itself,

strong evidence that the Settlement is reasonable and in the public interest. In fact, the Settlement reflects a carefully balanced compromise of the interests of all the Joint Petitioners based on their thorough and detailed consideration of the evidence adduced in this case, all of which was entered into the record at the evidentiary hearing conducted on January 14, 2015.

Significantly, three of the signatories – I&E, OCA, and OSBA – are charged with specific legal obligations to carefully scrutinize all aspects of a utility’s request to increase rates. I&E, which has the broadest mandate, functions as an independent prosecutorial bureau within the Commission and, as such, is charged with representing the public interest in utility rate proceedings.² The OCA has a statutory obligation to protect the interests of consumers of public utility service.³ And the OSBA represents the interests of small businesses.⁴ As evidenced by their active and extensive participation in all aspects of this case, these statutory parties have seriously and rigorously discharged their statutory obligations. Their joining in, and fully supporting, the Settlement is strong evidence that the Settlement’s terms and conditions are just, reasonable and in the public interest, as Administrative Law Judge Dunderdale previously concluded in her Recommended Decision approving the settlement of a base rate proceeding for a major natural gas distribution utility.⁵

Moreover, as fully explained hereafter, the Company presented a compelling case for rate relief. This is as evidenced by, among other factors, the fact that Penn Power’s base rates have not increased since 1988 (Penn Power St. No. 1, p. 4) and, since that time its net plant has

² See *Implementation of Act 129 of 2008 Organization of Bureaus and Offices*, Docket No. M-2008-2071852 (Final Order entered August 11, 2011), p. 5 (“BI&E will serve as the prosecutory bureau for purposes of representing the public interest in ratemaking and service matters . . .”).

³ See 71 Pa.C.S. §§ 309-1 *et seq.*

⁴ See 73 P.S. §§ 399.41 *et seq.*

⁵ *Pa. P.U.C. v. T.W. Phillips Gas and Oil Co.*, Docket Nos. R-2010-2167797 *et al.* (Recommended Decision issued October 5, 2010), 2010 Pa. PUC LEXIS 1598 at *80-85. Judge Dunderdale’s Recommended Decision was approved and adopted by the Commission in its final order entered November 4, 2010.

increased by more than 380%, which includes capital expenditures to enhance or maintain system reliability totaling \$127.3 million over the period from 2009 to 2013. *Id.* at 19 and 21. Penn Power's need for significant rate relief was confirmed by the litigation positions of I&E and OCA, which both concluded that the Company is entitled to a substantial increase in operating revenues (*see* I&E St. No. 2-SR, p. 37; OCA Exhibit LA-PP-1, p. 3).⁶

The Company's need for rate relief and the reasonableness of the increase in revenues set forth in the Settlement is addressed in detail in Section II, below. Section II also discusses all other terms of the Settlement and explains why they are reasonable in light of the evidence presented in this case and are in the public interest. Section III is a summation of the reasons why the Settlement as a whole is in the public interest.

A. The Settlement Is Consistent With Commission Policy, Practice And Precedent Concerning Settlements

The Commission's long-standing policy, practice and precedent, which are embodied in its regulation at 52 Pa. Code § 5.231 and its Policy Statement on settlements at 52 Pa. Code § 69.401, strongly encourage parties to resolve contested proceedings by settlement. Indeed, in its Policy Statement, the Commission stated that "the results achieved from a negotiated settlement or stipulation, or both, in which the interested parties have had an opportunity to participate are often preferable to those achieved at the conclusion of a fully litigated proceeding." There are many reasons why settlements can produce better outcomes and do a better job of promoting the public interest than full litigation, which have been repeatedly affirmed in decisions approving proposed settlements. Those reasons were aptly summarized in Administrative Law Judge

⁶ OSBA did not present a comprehensive analysis of revenue requirement. However, there was nothing in the litigation position articulated by its witness in this case to suggest that it disagreed with the fundamental conclusions of I&E and OCA with regard to the Company's need for rate relief.

Chestnut's Recommended Decision⁷ approving a black box settlement of PECO Energy Company's 2010 electric rate case, which provided for an increase in total operating revenues of \$225 million in lieu of its requested increase of \$315 million:

Settlements lessen the time and expense the parties must expend litigating a case and at the same time conserve administrative hearing resources. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa. Code § 69.401. Rate cases are expensive to litigate and the cost of such litigation at a reasonable level is an operating expense recovered in the rates approved by the Commission. This means that a settlement, which allows the parties to avoid the substantial costs of preparing and serving testimony and the cross-examination of witnesses in lengthy hearings, the preparation and service of briefs, reply briefs, exceptions and reply exceptions, together with the briefs and reply briefs necessitated by any appeal of the Commission's decision, yields significant expense savings for the company's customers. That is one reason why settlements are encouraged by long-standing Commission policy.

Although not explicitly discussed in Judge Chestnut's Recommended Decision, settlements also promote the public interest in another important way. In settlement, parties can, through compromise and agreement, craft innovative and creative solutions that the Commission may not be empowered to impose unilaterally. The Settlement in this case contains a number of terms that are excellent examples where such innovative and creative solutions have been achieved by agreement of the parties, as more fully explained in the Joint Petition and below.

⁷ *Pa. P.U.C. v. PECO Energy Co.*, Docket No. R-2010-2161575 (Recommended Decision issued November 2, 2010), p. 12. Judge Chestnut's Recommended Decision was approved and adopted by the Commission in its final order entered December 21, 2010.

B. Settlements That Neither Agree To, Nor Identify, The Specific Components Underlying A Settled Rate Increase Have Been Consistently Approved And Enthusiastically Endorsed By The Commission As Promoting The Public Interest

As the Joint Petition makes clear (*see* Paragraphs 10, 11A.6, and 14-16), the Joint Petitioners acknowledge that, subject to the limited exceptions set forth in the Joint Petition, they have not sought, nor would they be able, to agree upon the specific ratemaking adjustments that support their respective decisions to enter into the Settlement. Nonetheless, as the Joint Petitioners explain in their respective Statements in Support, they are in full agreement that the Settlement achieves the following goals:

- Resolves a number of contested issues, by means of inter-related compromises, in a manner that produces an overall outcome well within the range of reasonable outcomes supported by the record evidence;
- Appropriately and fairly balances: (1) the interests of customers in receiving safe, adequate and reliable service at just and reasonable rates; and (2) the interests of the Company and its shareholders in having a reasonable opportunity – through continued prudent and efficient management – to earn a fair return on their investment in property dedicated to the public service, which will support further investment in additional needed plant and equipment;
- Produces a fair result for all parties; and
- Therefore, for all the foregoing reasons, is in the public interest.

As explained above, the Joint Petition embodies a so-called “black box” settlement, because the Joint Petitioners have neither agreed upon, nor identified, their individual assessments of the various subsidiary components of the overall revenue requirement upon which they settled. The Joint Petitioners’ approach facilitates settlements by allowing parties to

agree to an overall outcome that all parties find reasonable without requiring them to abandon or reverse their litigation positions on issues they deem important and, thereby, compromise their ability to present their arguments in other proceedings where settlement may not be possible.⁸

In summary, within the give-and-take of the settlement process, some parties soften their positions on particular issues of importance to them in exchange for opposing parties softening their positions on issues they value. Thus, the net result is reasonable and acceptable to all, so long as the parties are not forced to reveal the positions, strategies and compromises they made to reach that result. Nonetheless, limited exceptions to the black box concept were made in this Settlement – as in other settlements that have been approved by the Commission – as needed to implement and administer the Settlement terms, such as specifying the time period for on-going amortizations, establishing the Storm Reserve Account discussed hereafter, and stipulating the benchmark return on equity to be used for determining future smart meter and Distribution System Improvement Charge (“DSIC”) revenue requirements.⁹

⁸ See 52 Pa. Code § 5.231 and the Commission’s Policy Statement on Settlements, *supra*. While there are many Commission-approved Recommended Decisions that have found black box settlements to be in the public interest on this basis, one of the most recent examples is *Pa. P.U.C. v. Borough of Ambler Water Department*, Docket No. R-2014-2400003 (Recommended Decision of Administrative Law Judge Cynthia Williams Fordham issued October 17, 2014). 2014 Pa. PUC LEXIS 547 at *12-15. In her Recommended Decision, Judge Fordham, after summarizing Commission precedent approving black box settlements, affirmed I&E’s position in that case that “the revenue amount and rate design in the Settlement are within the range of potential litigated outcomes” and “further line-by-line identification and ultimate resolution of each revenue-related issue raised in the proceeding beyond those addressed in the Settlement is not necessary to find that the Settlement is in the public interest . . .” *Id.* Judge Fordham’s Recommended Decision was approved and adopted by the Commission in its final order entered December 4, 2014. While *Borough of Ambler* involved a relatively smaller utility, black box settlements of base rate increases have been approved on the same basis for many large utilities, such as the \$225 million settlement of PECO’s 2010 electric rate case discussed previously. See, e.g., *Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-2014-2406274 (Final Order entered December 10, 2014) (approving a black box settlement for a base rate increase of \$32.5 million); *Pa. P.U.C. v. Duquesne Light Co.*, Docket No. R-2013-2372129 (Final Order entered April 23, 2014) pp. 8-15 (approving a black box settlement providing for a base rate increase of \$48 million); *Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-2010-2161694 (Final Order entered December 16, 2010), 2010 Pa. PUC LEXIS 2001 at *15 and *30-35 (approving a black box settlement providing for a base rate increase of \$77.5 million).

⁹ See, e.g., *Pa. P.U.C. v. Duquesne Light Co.*, Docket No. R-2010-2179522 (Recommended Decision of Administrative Law Judge Conrad A. Johnson dated January 28, 2011), 2011 Pa. PUC LEXIS 1012 at *43-51 (approving a “black box” settlement that did not identify any overall rate of return underlying the settlement increase, but, as a limited exception to the “black box” concept, specified a rate of return on equity solely for

The Joint Petitioners' approach to delineating the terms of the Settlement in the Joint Petition, namely, a "black box" subject to limited but appropriate exceptions, has been consistently and repeatedly approved by the Commission. One of the strongest endorsements of black box settlements as not only consistent with the public interest but a means of affirmatively promoting the public interest, occurred in two companion cases involving Citizens' Electric Company of Lewisburg, PA ("Citizens") and Wellsboro Electric Company ("Wellsboro"), which are subsidiaries of a common parent. Citizens and Wellsboro filed simultaneous base rate cases, which were assigned to Administrative Law Judge Buckley. Black box settlements were achieved in both cases. Judge Buckley approved the settlements in separate Recommended Decisions¹⁰ in which he found that "a justification for the 'Black Box' agreement is specifically offered in the OTS Supporting Statement," which he quoted in full, as follows:

The additional revenue in this proceeding is base rate revenue and has been agreed to in the context of a "Black Box" settlement with limited exceptions. A "Black Box" agreement does not specifically identify the resolution of any disputed issues. Instead, an overall increase to base rates is agreed to and parties retain all rights to further challenge all issues in subsequent proceedings. "Black Box" settlements benefit ratepayers as it [sic] allows for the resolution of a proceeding in a timely manner while avoiding significant additional expenses. OTS is of the opinion that an agreement as to the resolution of each and every disputed issue in this proceeding would not have been possible without judicial intervention. The involvement of the ALJ would have added time and expense to an already cumbersome proceeding. Avoiding this necessity will benefit ratepayers by keeping the expenses associated with this filing at a reasonable level.

purposes of calculating future smart meter revenue requirements to be recovered under Duquesne's smart meter adjustment clause). Judge Johnson's Recommended Decision was approved and adopted by the Commission in its final order entered February 24, 2011.

¹⁰ *Pa. P.U.C. v. Citizens' Electric Co. of Lewisburg, PA*, Docket No. R-2010-2172665 (Recommended Decision issued December 21, 2010), 2010 Pa. PUC LEXIS 1890 at *20-21; *Pa. P.U.C. v. Wellsboro Electric Co.*, Docket No. R-2010-2172662 (Recommended Decision issued December 21, 2010), 2010 Pa. PUC LEXIS 1891 at *17-18.

This increased level of “Black Box” revenue adequately balances the interests of ratepayers, shareholders and the Company. The Company will receive sufficient operating funds in order to provide safe and adequate service while earning an acceptable return on its investment for its shareholders. Ratepayers are protected as the resulting increase minimizes the impact of the Company's initial proposal.

The Commission approved both Recommended Decisions in final orders issued on January 13, 2010. In each case, Chairman Powelson issued separate but identical statements that stated, in relevant part, as follows:

I . . . will continue to support settlements, including those of a black box nature, enthusiastically. Determination of a company’s revenue requirement is a calculation that involves many complex and interrelated adjustments affecting revenue, expenses, rate base and the company’s cost of capital. To reach agreement on each component of a rate increase is an undertaking that in many cases would be difficult, time-consuming, expensive and perhaps impossible. *Black box settlements are an integral component of the process of delivering timely and cost-effective regulation.* (Emphasis added.)

Chairman Powelson’s separate statements in *Citizens’* and *Wellsboro, supra*, have been relied upon by parties, Administrative Law Judges and the Commission itself in many subsequent cases. For example, in Peoples TWP LLC’s 2013 base rate case, Judge Dunderdale issued a Recommended Decision approving a “black box” settlement and, in so doing, summarized I&E’s statement of reasons for finding the settlement in the public interest, including Chairman Powelson’s separate statements in *Citizens’* and *Wellsboro*:¹¹

Black box settlements benefit ratepayers because they allow for the resolution of a contested proceeding at a level of increase that is below, often substantially, that level requested by the regulated entity. Moreover, they do so in a manner that avoids the further expenditure of significant time and resources required from all

¹¹ *Pa. P.U.C. v. Peoples TWP LLC*, Docket No. R-2013-2355886 (Recommended Decision issued October 30, 2013), pp. 40-41.

parties, including the Commission, by further litigation. Finally, a settlement allows parties to mitigate the risks of litigation by providing each signatory party a compromised resolution that is acceptable in exchange for the certainty that accompanies a settled resolution of the case. While resolution of all individual issues is not identified, from a holistic perspective, each party has agreed that the Settlement satisfies and benefits its respective interests.

The use of black box settlements is not uncommon in Commission practice. Indeed, the Commission has enthusiastically endorsed the use of black box settlements, as noted in a statement by then Commissioner, now Chairman Powelson, approving such a settlement:

I . . . will continue to support settlements, including those of a black box nature, enthusiastically. Determination of a company's revenue requirement is a calculation that involves many complex and interrelated adjustments affecting revenue, expenses, rate base and the company's cost of capital. To reach agreement on each component of a rate increase is an undertaking that in many cases would be difficult, time-consuming, expensive and perhaps impossible. Black box settlements are an integral component of the process of delivering timely and cost-effective regulation.

Moreover, the Commission has recognized a settlement "reflects a compromise of the positions held by the parties of interest, which, arguably fosters and promotes the public interest." The Settlement in this proceeding promotes the public interest because a review of the testimony submitted by all parties demonstrates the Joint Petition reflects a compromise of the litigated positions held by those parties and presents results that are within the range of potential litigated outcomes.

BIE individually, and Joint Petitioners collectively, considered, discussed, and/or negotiated in this Settlement the merits of all issues of importance. Further line-by-line identification and ultimate resolution of each and every revenue-related issue raised in the proceeding beyond those addressed in the Settlement is not necessary to find that the Settlement is in the public interest nor could such a result be achieved as part of a settlement.¹²

¹² *Id.* at 40-41.

Exceptions were filed to the Recommended Decision by a non-settling complainant who, among other objections, challenged the “black box” nature of the settlement and contended that the settlement “should provide specifically which adjustments are allowed or disallowed and explain these adjustments in detail.”¹³ The Commission denied all of the objecting party’s exceptions, approved the settlement and adopted the Recommended Decision. In response to the complainant’s objection to the black box nature of the settlement, the Commission expressly stated that its holding was squarely based on Chairman Powelson’s statements in *Citizens’* and *Wellsboro*¹⁴:

We have historically permitted the use of “black box” settlements as a means of promoting settlement among the parties in contentious base rate proceedings. *See, Pa. PUC v. Wellsboro Electric Co.*, Docket No. R-2010-2172662 (Final Order entered January 13, 2011); *Pa. PUC v. Citizens’ Electric Co. of Lewisburg, PA*, Docket No. R-2010-2172665 (Final Order entered January 13, 2011). Settlement of rate cases saves a significant amount of time and expense for customers, companies, and the Commission and often results in alternatives that may not have been realized during the litigation process. Determining a company’s revenue requirement is a calculation involving many complex and interrelated adjustments that affect expenses, depreciation, rate base, taxes and the company’s cost of capital. Reaching an agreement between various parties on each component of a rate increase can be difficult and impractical in many cases. For these reasons, we support the use of a “black box” settlement in this proceeding and, accordingly, deny this Exception.

The Commission’s strong policy against requiring “line-by-line identification and ultimate resolution of each and every revenue-related issue raised in the proceeding”¹⁵ as a condition precedent to approving a settlement extends to the cost of capital and, in particular, the

¹³ *Pa. P.U.C. v. Peoples TWP LLC*, Docket No. R-2013-2355886 (Final Order entered December 19, 2013), p. 27.

¹⁴ *Id.* at 28.

¹⁵ See Chairman Powelson’s statements in *Citizens’* and *Wellsboro* and the Commission’s holding in *Peoples TWP*, *supra*.

return on equity assumptions of each settling party. The Commission made this point emphatically in its final order approving a black box settlement of Aqua Pennsylvania, Inc.'s ("Aqua PA") 2009 base rate case.¹⁶ In that proceeding, the settling parties did not agree to, or identify, either an overall rate of return or a rate of return on equity. A non-settling party challenged the settlement on the grounds, among others, that the revenue increase agreed to in the settlement would allow Aqua PA to earn an excessive rate of return.

The presiding Administrative Law Judge approved the settlement and rejected the non-settling party's objections. In her Recommended Decision, she tried to use evidence in the record to interpolate the settlement's implicit return on equity in order to show that it was adequate but not excessive.¹⁷ The Commission approved the settlement and rejected the arguments of the non-settling party. However, the Commission expressly rejected the Administrative Law Judge's efforts to discern an implicit rate of return on equity underlying the level of revenues agreed to under the settlement and held that any attempt to do so was neither proper nor necessary in the context of a rate case settlement.¹⁸

In considering the proposed Joint Settlement, we are determining, *inter alia*, whether an increase of \$26.3 million in annual operating revenue is in the public interest without making a determination of any specific components that may have led to the calculation of the specific revenue requirement. Consequently, we are unable to make any determination regarding the rate of return on equity that Aqua may ultimately realize from the rates adopted under the proposed Settlement. Accordingly, we cannot adopt the ALJ's finding that an estimated 10.5% rate of return that may be the result of the proposed Joint Settlement is preferable to the *pro forma* rate of return granted in Aqua's prior rate proceeding.

¹⁶ *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-2009-2132019 (Final Order entered June 16, 2010), 2010 Pa. PUC LEXIS 1808.

¹⁷ *Id.* at *35-38.

¹⁸ *Id.* at *38-39.

Similarly, there is no basis to address Mr. Linden's positions that the rate of return that may result from this Settlement will provide an excessive return. Therefore, we reject Mr. Linden's Exceptions and reject the ALJ's findings that are based on an estimated rate of return that may result from the proposed Joint Settlement.

In summary, the Commission has clearly stated that rates of return, like other components of revenue requirement, need not be stipulated or identified as a condition precedent to approving a settlement.

C. The December 5, 2014 Prehearing Order

In their Prehearing Order issued on December 5, 2014 (p. 7), Administrative Law Judges Buckley and Dunderdale ("ALJs") acknowledged that any settlement in this case would be a "black box" and that, in such settlements, "the parties have not negotiated each and every revenue and expense line item but rather have, after considerable effort, been able to agree upon a final revenue number based on their individual revenue and expense analysis." Nonetheless, the Order also refers to a need to specify a rate of return and rate of return on equity.

The Company, in conjunction with the Joint Petitioners, has carefully considered the reference to specifying a rate of return set forth in the December 5, 2014 Order in light of three important factors: (1) the Recommended Decisions issued by the ALJs approving black box settlements in other base rate cases, as previously discussed; (2) the Commission's prior decisions endorsing black box settlements and expressly rejecting the need to specify an overall return rate or rate of return on equity; and (3) as discussed below, settlements in other cases, in which limited exceptions were made to the black box concept to specify a return on equity solely for purposes of calculating smart meter or DSIC revenue requirement in the future, when changes in a smart meter adjustment clause or DSIC might be proposed. Based on that substantial body of authority, the Company, in conjunction with the other Joint Petitioners, has

concluded that the ALJs' admonition regarding specifying a rate of return on equity was intended to have a limited scope. Specifically, it was to relate only to a rate of return on equity to be used for purposes of calculating future smart meter revenue requirements to be reflected in possible future changes to the Company's Smart Meter Technologies Charge ("SMT-C").¹⁹

This understanding of the December 5, 2014 Order is consistent with a number of Recommended Decisions in other cases in which Administrative Law Judges, with the Commission's affirmation, approved settlements that provided for limited exceptions to the black box concept for the sole and express purpose of specifying a return on equity to be used to calculate future smart meter revenue requirement or future revenue requirement to be recovered under a DSIC. Thus, Judge Johnson described such a limited exception in approving a black box settlement of Duquesne Light's 2010 base rate case²⁰:

According to Duquesne, the revenue requirement under the Settlement is generally a "black box" number. The Joint Petitioners entered into a "black box" Settlement wherein the Joint Petitioners do not specifically identify revenues and expenses that are allowed or disallowed. Duquesne claims the "black box" concept often facilitates settlement agreements because parties are not required to identify a specific return on equity (ROE) or identify revenues and/or expenses that are allowed or disallowed. This process, according to Duquesne, allows a settlement without requiring parties to abandon or reverse their positions on important issues, which could impact their positions in later cases. Duquesne St. in Support, p. 5.

Duquesne points out that exceptions to the "black box" concept under this Settlement were made to specify universal service costs to be recovered under Rider No. 5 and consumer education costs to be recovered under Rider No. 1. According to Duquesne, the parties had to specify the amounts to be recovered under Rider No. 5 and Rider No. 1 in order to develop the Settlement rates. . . .

¹⁹ The SMT-C is an adjustment clause that currently exists in the Company's tariff and was approved by the Commission under Section 1307 of the Public Utility Code, 66 Pa.C.S. § 1307, to recover (or refund) smart meter revenue requirement not reflected in base rates.

²⁰ *Pa. P.U.C. v. Duquesne Light Co.*, *supra*, 2011 Pa. PUC LEXIS 1012 at *43-44.

The Joint Petitioners also specified a return on equity and an equity component for purposes of the Smart Meter Recovery, as directed by the Commission. Duquesne St. in Support, p. 5. (Emphasis added.)

A limited exception to the black box settlement concept was also made in the settlement of PECO's 2010 electric base rate case, which also specified a rate of return for use in calculating smart meter revenue requirements.²¹ Similar, limited exceptions to the black box concept have also been made to specify a return on equity to be used for future DSIC calculations.²² In fact, with respect to the DSIC, the Commission, in implementing the provisions of Act 11 of 2012, recognized that parties can make limited exceptions to a black box settlement to specify a return on equity to be used solely for DSIC purposes.²³

Based on its reading of the relevant portions of the December 5, 2014 Order, the Company, in conjunction with the other Joint Petitioners, has agreed to a term of the Settlement that stipulates the benchmark for determining the rate of return on equity to be used to calculate: (1) future smart meter revenue requirements; and (2) future DSIC revenue requirements, in the event the Company hereafter requests, and the Commission approves, a DSIC. This Settlement term is discussed in more detail in Section II, below. The Company and the other Joint Petitioners share the firm belief that this term of the Settlement fully complies with the relevant portions of the December 5, 2014 Order as it was intended by the ALJs and as it should be understood in light of the extensive list of decisions articulating the Commission's policy and practice regarding black box settlements, as discussed above.

²¹ *Pa. P.U.C. v. PECO Energy Co.*, *supra*, Recommended Decision, pp. 8 and 16-17.

²² *See, e.g., Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-2011-2267958 (Final Order entered June 7, 2012), p. 37.

²³ Implementation of Act 11 of 2012, Docket No. M-2012-2293611 (Final Order entered August 2, 2012), pp. 31-37.

D. General Standard For Approval Of Settlements

It is well-established that, in order to accept a settlement, the Commission must determine that the proposed terms and conditions, viewed in the context of the settlement as a whole, are in the public interest. *See Pa. P.U.C. v. CS Water & Sewer Assoc.*, 74 Pa. P.U.C. 767, 771 (1991); *Pa. P.U.C. v. Philadelphia Electric Co.*, 60 Pa. P.U.C. 1, 22 (1985). In Section II, below, each of the principal terms of the Settlement are discussed in light of the record evidence and the parties' positions. As explained therein, the final resolution achieved by each of those terms is consistent with, and promotes, the public interest. Additionally, Section III provides a summation of the reasons that the Settlement as a whole is in the public interest and should be approved without modification.

II. SPECIFIC SETTLEMENT TERMS²⁴

A. Revenue Requirement (Joint Petition, Paragraph 11.A.)

On August 4, 2014, Penn Power filed with the Commission Tariff Electric – Pa. P.U.C. No. 36 (“Tariff No. 36”) which reflected an increase in annual distribution revenues of \$28.5 million, or 8.7% of its total electric operating revenues. The proposed increase consisted of an increase in base rate operating revenues of \$29.557 million, including the roll-in to base rates of smart meter revenue requirement, as well as proposed decreases in the Default Service Support and Hourly Pricing Default Service Riders totaling \$1.074 million (*see* Penn Power St. No. 1, p. 8). On October 2, 2014, the Commission adopted an Order (the “Suspension Order”) suspending the tariff filing and referring it to the Office of Administrative Law Judge for an investigation to

²⁴ Section II of this Statement in Support contains a general description of the terms and conditions of the Settlement set forth in the Joint Petition. While every effort has been made to try to ensure that the descriptions are accurate, if any inconsistency exists or is perceived between the Statement in Support and the terms and conditions of the Joint Petition, the Joint Petition shall take precedence and shall control.

determine the lawfulness, justness, and reasonableness of the rates, rules, and regulations proposed by Penn Power. Accordingly, Penn Power's Tariff No. 36 was suspended by operation of law until May 3, 2015.

As previously explained, following detailed discovery, the submission of multiple rounds of testimony and extensive negotiations, the Joint Petitioners agreed to the Settlement embodied in the Joint Petition. Under the terms of the Settlement, Penn Power will be entitled to charge base rates designed to produce an increase in distribution operating revenues of \$17 million, or approximately 5.2% of total operating revenues, based on billing units for the twelve months ended April 30, 2016, to become effective no later than May 19, 2015 ("Settlement Rates"). The Company will recoup, through a surcharge, revenues lost at the final approved rates for the period from the end of the statutory suspension period (May 3, 2015) through the date the Commission allows the Settlement Rates to be charged, if that date is later than May 3, 2015 (Joint Petition, Paragraph 11.A.1).²⁵ The Joint Petition also describes how the surcharge will be calculated and implemented. *Id.*

Under Penn Power's distribution rates in effect at the time of its filing and its default service rate that became effective in September 2014, a typical residential customer of the Company using 1,000 kWh per month paid a monthly bill of \$104.76 (Penn Power St. 1, p. 10). Using, for comparison, the rates of the other three major, non-affiliated Pennsylvania electric

²⁵ The use of a surcharge to recover revenues lost at the Commission-approved rates between the end of the statutory suspension period and May 19, 2015, is consistent with the practice the Commission has historically employed to allow recovery of lost revenues between the end of the statutory suspension period and the approval of a compliance filing in fully litigated proceedings. *Pa. P.U.C. v. Peoples Natural Gas Co.*, 69 Pa. P.U.C. 427, 434 (1989). *See also Bell Tele. v. Pa. P.U.C.*, 69 Pa. Cmwlth. 554, 452 A.2d 86 (1982), *aff'd*, 505 Pa. 603, 482 A.2d 1272 (1984). The use of a surcharge as set forth in Joint Petition was part of an agreed-upon exchange among all parties for the Company's consent to extend from May 3, 2015 to May 19, 2015 the time for the Commission to enter a final order in this case. That agreement was approved by the Administrative Law Judges (Prehearing Conference Transcript of October 8, 2014, pp. 53-57) and was expressly set forth in the suspension tariff supplement filed by Penn Power on October 29, 2014. The Joint Petitioners have reaffirmed the parties' prior, approved agreement on this matter in the Joint Petition.

distribution companies (“EDCs”) in effect at the time of the Company’s filing, residential customers of those companies with 1,000 kWh of usage paid a monthly bill of between \$137.05 and \$153.19. *Id.* Moreover, at Penn Power’s proposed base rates, a 1,000 kWh residential default service customer would have paid a total bill of \$117.15, which would be considerably lower than that of a similar customer of the other three Pennsylvania EDCs. *Id.* at 11. At the Settlement Rates, and consistently applying the riders used in the prior bill comparison, a residential customer of Penn Power using 1,000 kWh per month would pay a total monthly bill of \$112.56, which is even lower than the bills of all the other non-affiliated Pennsylvania EDCs for comparable usage at the time of the Company’s filing.

The increase in customer rates and total annual operating revenues under the Settlement must be viewed in the context of the period since the Company’s last increase in base rates became effective. Penn Power’s current base rates were established when its base rates were functionally unbundled pursuant to the Commission’s Final Order issued July 22, 1998 at Docket No. R-00974149. Prior to that case, Penn Power had last increased its base rates pursuant to the Commission’s Final Order entered May 3, 1988 at Docket No. R-870732. Therefore, if the Settlement is approved, customers of Penn Power will have experienced no increase in distribution base rates in twenty-seven years. *See Penn Power St. 1, p. 4.*

The interval between base rate increases that Penn Power customers have experienced to date has been a result of a number of factors. However, a significant contributor to Penn Power’s ability to forestall a rate case was its aggressive management of operating and maintenance (“O&M”) expenses and, in particular, administrative and general (“A&G”) expenses. *Penn Power St. 1, p. 23.* In addition to continuous efforts to diligently control expenses on a day-to-day basis, Penn Power has benefited from various initiatives that allowed it

to control all expenses and, in particular, A&G expenditures. Some of the initiatives that have had the most significant impacts include the following:

Capturing economies of scale and maximizing merger related synergies. FirstEnergy Corp. (“FirstEnergy”), Penn Power’s parent, was the acquirer in three major mergers since 1997. FirstEnergy itself was formed on November 7, 1997, as the parent of Ohio Edison Company (“Ohio Edison”) to facilitate Ohio Edison’s acquisition of Centerior Energy Corporation (“Centerior”). This merger created a single holding company structure that included Centerior’s operating utilities,²⁶ Ohio Edison, which was itself an operating utility, and Penn Power, as Ohio Edison’s Pennsylvania subsidiary. In 2001, GPU, Inc. (“GPU”) merged with FirstEnergy, which added Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”) and Jersey Central Power & Light Company to FirstEnergy’s family of operating electric utilities. In 2011, Allegheny Energy, Inc. (“Allegheny Energy”) merged with FirstEnergy, which added to the holding company system Allegheny Energy’s operating subsidiaries, consisting of Monongahela Power Company, Potomac Edison Company and West Penn Power Company (“West Penn”). FirstEnergy Service Company was established in its current form in order to capture economies of scale by providing various services on a shared basis across all of FirstEnergy’s subsidiaries. In addition, FirstEnergy implemented standardized programs and business processes that adopt the best practices identified among its various operating subsidiaries. Penn Power and other utilities in the FirstEnergy system have been major beneficiaries of these practices, which maximized the savings achievable from the various business combinations by eliminating duplication, capturing other economies of scale and implementing best practices following each of those acquisitions. Penn Power St. 1, p. 12.

²⁶ Centerior’s utility subsidiaries consisted of The Cleveland Electric Illuminating Company and The Toledo Edison Company.

Aggressive management of indirect labor-related costs. Most of the Other Post-Employment Benefits (“OPEBs”) formerly provided to FirstEnergy Service Company employees and utility supervisory, management, and non-bargaining unit employees have been eliminated. This measure and other measures to aggressively manage employee benefit costs while maintaining a competitive compensation package have helped the Company and other utilities in the FirstEnergy system to contain their labor-related costs. *Id.* at 12-13.

Focus on maintaining and enhancing reliability. In order to enhance reliability, the Company has aggressively pursued projects to replace aging or vulnerable infrastructure, which necessarily required higher levels of capital expenditures. These efforts enhanced reliability and, thereby, directly reduced maintenance expenses. *Id.* at 13.

Notwithstanding Penn Power’s successful efforts to manage and contain O&M expenses, three principal factors were major contributors to the Company’s need to increase its distribution base rates:

Growth in the Company’s distribution rate base. The single biggest factor driving the need for rate relief is the growth in Penn Power’s rate base attributable to increases in net investment in distribution plant in service. As previously noted, a significant portion of these investments were made to enhance or maintain reliability and, in fact, Penn Power invested \$127.30 million in reliability-related projects during the five years ended December 31, 2013 (Penn Power St. 1, p. 19). The growth in Penn Power’s rate base is shown in the table below, which compares net distribution plant in service as of April 30, 2016, derived from the Company’s Exhibit RAD-1, to its net investment in distribution plant derived from its Form 1 filed with the Federal Energy Regulatory Commission for 1988, which was the year of its last base rate case. That difference reasonably depicts the additional investment the Company has

made in net distribution plant in service since its last base rate case and confirms that growth in rate base is a significant component of its requested distribution rate increase (Penn Power St. 1, pp. 20-21).

Year of Last Base Rate Case	1988
Net Plant in Service (000)	\$87,447
Net Plant in Service at 4/30/2016 (Ex. RAD-1) (000)	\$420,106
Growth in Net Plant	380.41%

Depreciation expense associated with increased investment in plant in service. The increases in distribution plant in service produced corresponding increases in depreciation expense. *Id.* at 21. These increases in depreciation expense significantly reduced the Company's operating income over the period that new plant and equipment was being placed into service.

Increase in depreciation expense related to retirement of legacy meters. Act 129 of 2008 added Section 2807(f) to the Pennsylvania Public Utility Code, requiring EDCs to adopt and implement smart meter and AMI technology for all customers. The Company is implementing a Commission-approved Smart Meter Plan under which it will replace 95% of all existing meters with smart meters by mid-2019, or approximately three years from the end of the fully projected future test year. Absent the smart meter mandate of Section 2807(f) and the adoption of the Company's Smart Meter Plan, the Company's existing "legacy" meters would have remained in service and continued to be depreciated over the average remaining lives of between twenty-three and forty-eight years, as reflected in the Companies' existing distribution base rates. The remaining investment in legacy meters must be recovered over a much shorter

time period (five years, both as proposed by the Company and as provided in the Settlement), which produces a material increase in depreciation expense. *Id.* at 21-22.

Due in large part to the factors discussed above, and notwithstanding its success in containing O&M expenses, Penn Power's overall rate of return at present rates is projected to be 3.98% for the fully projected future test year. More importantly, the indicated return on common equity under present rates is anticipated to be 2.56% (Penn Power Ex. CVF-1), which is inadequate by any reasonable standard. A return at that level is not sufficient to support the substantial amounts of additional investment the Company will be required to make to maintain and enhance reliability, replace aging infrastructure, and fully implement its Smart Meter Plan while continuing to provide customers safe, reliable and high-quality service. Accordingly, it is critically important that the Company obtain the rate relief the Settlement will provide. Penn Power St. 1, p. 25.

The Joint Petition also contains six additional provisions that pertain to revenue requirement and cost recovery, which consist of the following:

Recovery in base rates of smart meter revenue requirements (Joint Petition, Paragraph 11.A.2). Penn Power currently recovers its smart meter costs through its SMT-C Rider. In this case, Penn Power proposed base rates that include the roll-in of smart meter costs currently being recovered under its SMT-C as well as smart meter revenue requirements to be incurred through the end of the fully projected future test year, and also proposed to reduce the SMT-C to zero upon the conclusion of this case (*see* Penn Power St. 7-R, p. 2). Section 2807(f) of the Public Utility Code, 66 Pa.C.S. § 2807(f), provides statutory authority for an EDC to recover smart meter plan costs in base rates, as the Commission affirmed in its Opinion and Order entered August 3, 2010 in *Joint Petition of Metropolitan Edison Company, Pennsylvania*

Electric Company and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan, Docket No. M-2009-2123950 (the “August 3, 2010 Order”) (see Penn Power St. 7, p. 9).²⁷

No party disagreed with the Company’s proposal. In fact, the OCA had previously endorsed the roll-in to base rates of smart meter revenue requirements (see August 3, 2010 Order, pp. 4-6). Accordingly, Paragraph 11.A.2. of the Joint Petition provides that the Settlement Rates reflect the recovery in base rates of revenue requirement of \$12.483 million associated with smart meter deployment. The same paragraph also provides that, when the Company incurs revenue requirements associated with smart meter deployment that exceed \$12.483 million, those incremental costs may be deferred and the Company will be entitled to file a smart meter rate under its SMT-C to recover revenue requirements in excess of the amount included in base rates.

Legacy meters (Joint Petition, Paragraph 11.A.3). As previously explained in the discussion of factors driving the Company’s need for rate relief, because of the deployment of smart meters pursuant to its Commission approved Smart Meter Plan, the Company will be retiring its legacy meters well before the end of the service lives that had previously been used to calculate annual depreciation – and recover the cost – of such meters. Consequently, the Company proposed to recover its unrecovered investment in legacy meters by amortization over a period of five years from the date rates established in this case become effective. Paragraph 11.A.3 of the Joint Petition provides that the Settlement Rates reflect that amortization.

Storm Reserve Account (Joint Petition, Paragraph 11.A.4). As part of its rate filing, Penn Power proposed that its base rates should recover only a normal level of storm damage

²⁷ Additionally, in response to a request by the Administrative Law Judges, on October 10, 2014, Penn Power submitted a letter of counsel setting forth the authority to request the roll-in of smart meter costs to base rates and reduce its SMT-C to zero and provided, as an attachment, the August 3, 2010 Order.

expenses and that a rate adjustment mechanism (i.e., a “Storm Charge Rider”) be established under Section 1307 of the Public Utility Code, 66 Pa.C.S § 1307, to impose a charge or credit on customers’ bills to reflect the difference, on an annual basis, between the storm damage expenses recovered in the Company’s base rates and the storm damage expenses it actually incurs (Penn Power St. 3, pp. 26-32). In support of its proposal, the Company explained that the Commission had previously approved the concept of a rider to recover storm damage expense in its December 28, 2012, Final Order in PPL Electric Utilities Corporation’s (“PPL”) base rate case at Docket No. R-2012-2290597. In a subsequent order entered on April 3, 2014, at the same docket, the Commission approved, with modifications, PPL’s proposed Storm Damage Expense Rider. In that order, the Commission expressly found that storm damage expenses: (1) are not within the control of a utility; (2) are recoverable utility expenses that can be readily identified; (3) are highly variable and difficult to project; and (4) represent “a significant imposition on the [a utility’s] opportunity to earn an approved rate of return” (April 3, 2014 Final Order, pp. 21-23). Additionally, the Commission found that innovative approaches to assuring timely and accurate recovery of storm damage expenses are “particularly appropriate given the size of recent storm events and our increasing emphasis on enhanced system reliability.” *Id.* at 23.

Several parties opposed the Company’s proposal to establish a Storm Charge Rider and argued that, notwithstanding the Commission’s orders approving PPL’s Storm Damage Expense Rider, storm damage costs should not be recovered under a Section 1307 adjustment mechanism. Certain parties also noted that the Commission’s PPL order was under appeal to the Commonwealth Court. I&E, in addition to objecting to the Company’s proposed Storm Charge Rider, proposed an alternative approach to storm cost recovery that it advanced as a means to reduce the risk of over or under collection of storm damage costs and to reduce the rate volatility

that results from traditional base rate recovery of such costs. Specifically, I&E's witness, Lisa A. Boyd, recommended establishing a storm cost reserve account that would be funded by an appropriate allowance in base rates and trued-up through an annual reconciliation in conjunction with a rider to recover or refund differences identified in the annual reconciliation (I&E St. 5, pp. 21-26). In rebuttal testimony, the Company explained that it saw merit in I&E's proposal and found it acceptable (Penn Power St. 3-R, pp. 10-11). Other parties, while not opposed to the concept of a storm damage reserve account, objected to the use of a rider to adjust customer rates based on an annual reconciliation (*see* OCA St. 1R).

Paragraph 11.A.4 of the Joint Petition provides that the Company will establish a Storm Reserve Account that does not involve the creation of a rider to annually true-up the reserve account with the difference between storm costs included in base rates and actual storm costs. Specifically, Paragraph 11.A.4 provides as follows:

A Storm Reserve Account will be established and maintained on the Company's balance sheet beginning on the date the Settlement Rates become effective. The Company's total revenue requirement includes \$1 million to be recovered for purposes of funding this reserve, which represents a five-year average of historical expenses. Penn Power's historical expenses for that period did not include any expenses related to damage from extraordinary storm events which the Company received Commission approval to defer. Expenses related to storm damage, excluding those expenses related to damage from extraordinary storm events, will be recorded in the Storm Reserve Account in order to eliminate any impact of such expenses on the Company's income statement. Expenses related to damage from extraordinary storm events will be accounted for separately in accordance with the current practice of petitioning the Commission for approval to defer such expenses. Both revenues received and costs incurred by the Company in support of other regulated utilities, including other jurisdictional and non-jurisdictional affiliated companies, for assisting during storm events will be reflected in the reserve account.

The Storm Reserve Account will help to achieve the two goals of I&E's initial proposal, namely, to reduce the risk that the Company would collect either too little or too much of its actual storm damage expenses and to mitigate volatility in revenue requirement and the corresponding volatility of customer rates caused by fluctuations in storm damage expenses. The expenses related to extraordinary storm events will be subject to deferral based on the Company's filing separate petitions to obtain Commission approval of such deferrals. The costs thus deferred will be separately identified and claimed in subsequent base rate proceedings.

While achieving the important goals delineated above, the Storm Reserve Account provision, as set forth in the Joint Petition, does not include the elements that were the target of various parties' objections to both the Company's Storm Charge Rider and I&E witness Boyd's initial proposal to establish a storm reserve account.

Reporting and updating of fully projected future test year data (Joint Petition, Paragraph 11.A.5). As previously explained, the Company has presented, and had relied upon, data for a fully projected future test year ending April 30, 2016. I&E witness Jeremy B. Hubert proposed that the Company provide various reports and updates to reflect actual rate base additions and actual expenses relative to the amounts included in its fully projected future test year revenue requirement (I&E St. 3, pp. 12-13). The Company did not agree with the specific reporting and updating requirements that Mr. Hubert asked to be imposed (*see* Penn Power St. 2-R, pp. 10-11). As part of the Settlement, the parties have agreed to specific updates to Company Exhibits RAD-47 and RAD-46, to be submitted to the statutory advocates by August 1, 2015 and July 1, 2016, respectively, to report actual capital expenditures, plant additions, and retirements. Additionally, the Company agreed to provide in its next base rate case a comparison of projected to actual expenses and rate base additions for the fully projected future test year in this case.

With respect to these reporting provisions, the Joint Petitioners expressly agreed that they are for informational purposes only and do not suggest any agreement among the parties as to specific components of the revenue requirement that is being recovered in the Settlement Rates (except to the extent specifically stated in other provisions of the Joint Petition).

Return on equity for smart meter and DSIC revenue requirements (Joint Petition, Paragraph 11.A.6). As explained in Section I, *supra*, the revenue requirement elements of the Settlement reflect, for the most part, a matrix of compromises by the Joint Petitioners and, therefore, specific ratemaking adjustments are not spelled out in the Joint Petition, subject to limited exceptions. Certain of those exceptions (e.g., smart meter revenue requirements, agreed amortizations, and the Storm Reserve Account) were explained previously. In addition, the Joint Petitioners have recognized that, notwithstanding the “black box” nature of the Settlement regarding revenue requirement, it is important to resolve, as part of the Settlement, the rate of return on equity that Joint Petitioners agree should be used by the Company in computing: (1) incremental revenue requirements associated with smart meter deployment that exceed the smart meter revenue requirements being recovered in the Settlement Rates (as previously explained, under Paragraph 11.A.2, such excess revenue requirements would be eligible for recovery under the Company’s SMT-C); and (2) a DSIC, in the event such a charge is proposed by the Company and approved by the Commission. To that end, the Joint Petitioners have agreed and stipulated in Paragraph 11.A.6 of the Joint Petition that the Company shall use the rate of return on equity as calculated for electric utilities and published in the “Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Utilities” (“TUS Quarterly Earnings Report”) for the most recent period prior to the time that a DSIC or SMT-C rate is calculated.²⁸ The TUS

²⁸ The most recent TUS Quarterly Earnings Report was issued on January 29, 2015 at Docket No. M-2015-2460381 for the period ended September June 30, 2014.

calculation is a recognized and accepted benchmark return on equity for use in calculating revenue requirement under the DSIC and other similar riders. Moreover, TUS regularly updates its calculation to reflect changes in market-determined equity costs based on a clearly stated methodology and data base.

Penn Power’s State Tax Adjustment Surcharge (“STAS”) (Joint Petition, Paragraph 11.A.7). As required by the Commission’s order establishing the STAS, the Company is rolling into base rates all of the state taxes reflected in its current STAS and reducing its STAS to zero. As a consequence, it is also necessary for the Company to revise various riders to reflect a similar roll-in to those charges, from and after the effective date of the Settlement Rates, to recover Gross Receipts Tax, including the Revenue Neutral Reconciliation, that are currently recovered on amounts billed under the designated riders by applying the STAS to those billed amounts. No party has objected to this the Company’s proposal, and it is incorporated in Paragraph 11.A.7 of the Joint Petition.

The revenue requirement provisions of the Settlement are reasonable and in the public interest. In its final order approving the settlement of Aqua PA’s 2009 base rate case, the Commission outlined the following general principles for assessing whether a settlement meets the public interest standard:²⁹

The purpose of this investigation is to establish rates for Aqua customers which are “just and reasonable” pursuant to Section 1301 of the Public Utility Code (Code), 66 Pa. C.S. § 1301. A public utility seeking a general rate increase is entitled to an opportunity to earn a fair rate of return on the value of the property dedicated to public service. *Pennsylvania Gas and Water Co. v. Pennsylvania Pub. Util. Comm’n*, 341 A.2d 239 (Pa. Cmwlth. 1975). In determining what constitutes a fair rate of return, the Commission is guided by the criteria set forth in *Bluefield Water*

²⁹ *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, *supra*, 2010 Pa. PUC LEXIS 1808 at *22-24.

Works and Improvement Co. v. Public Service Comm'n of West Virginia, 262 U.S. 679 (1923) and *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). In *Bluefield* the United States Supreme Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

Significantly, neither the Public Utility Code nor principles of due process require the Commission to adhere to a specific formula or methodology to determine “just and reasonable” utility rates.³⁰ Indeed, Pennsylvania appellate precedent³¹ holds, as follows:

[T]he power to fix “just and reasonable” rates imports a flexibility in the exercise of a complicated regulatory function by a specialized decision-making body and that the term “just and reasonable” was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility customers and returns on capital to utility investors consonant with constitutional protections applicable to both.

³⁰ See *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 315-16 (1989) (“the Commission was not bound to the use of any single formula or combination of formulae in determining rates”), quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944).

³¹ *Pa. P.U.C. v. Pennsylvania Gas and Water Co.*, 492 Pa. 326, 337, 424 A.2d 1213, 1219 (1989).

In short, “just and reasonable” rates, like the allied concept of a “fair return,” are not point values. Rather both “just and reasonable” rates and “fair return” exist within a “constitutional range of reasonableness.”³² And, there are a variety of ways in which the parameters of the “constitutional range of reasonableness” can be determined. As long-standing Commission precedent establishes, one important way of identifying a value within the acceptable “range” is through the settlement process. In that way, parties with differing interests engage in an adversarial process to scrutinize the evidence supporting a rate request and, based on robust negotiations, agree to a reasonable overall outcome.

Applying the ratemaking principles discussed above and the standards employed by the Commission for assessing settlements, the revenue level set forth in the Settlement is reasonable, in the public interest and should be approved. As previously explained, the interval since the Company’s last base rate case and the significant increase in its plant in service since that time present a compelling case for significant rate relief. That assessment was confirmed by the litigation positions of I&E and OCA, which concluded that the Company is entitled to a substantial increase in operating revenues. *See* Section I, *supra*.

Moreover, with respect to the *Bluefield*, *Hope*, and *Barasch* standards, the Settlement carefully balances: (1) the right of the Company and its investors “to earn a return on the value of the property which it employs for the convenience of the public” and “to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties”; with (2) the right of customers to pay rates that are commensurate with “business undertakings which are attended by corresponding risks and uncertainties” without providing the utility

³² *Duquesne Light Co.*, *supra*, 488 U.S. at 312. *See also*, *Pennsylvania Gas and Water Co.*, *supra*.

“profits . . . realized or anticipated in highly profitable enterprises or speculative ventures.”³³

That balance is assured by the fact that parties legally obligated to protect consumers and the public interest vigorously investigated all aspects of the Company’s proposed increase and concluded that the Settlement Rates are just and reasonable. Similarly, the Company carefully considered the proposed revenue increase in light of the obligation to its investors to secure a reasonable opportunity to earn a fair return, maintain the financial stability of its business, and obtain needed capital on reasonable terms. The Company concluded that the Settlement Rates satisfy those criteria.

While the Settlement Rates provide a lower overall level of distribution base rate revenues than originally proposed, the Company assessed the Settlement Rates in conjunction with other significant components of the Settlement, including provisions for amortizing legacy meter costs, the establishment of a Storm Reserve Account, and the opportunity to recover smart meter revenue requirements above the level included in base rates through its SMT-C Rider. In each instance, those additional terms provide the Company a reasonable opportunity to recover its costs to furnish utility service while ameliorating the impact of cost recovery on customers by amortizing costs over reasonable periods (e.g., legacy meter costs) and creating an innovative mechanism – the Storm Reserve Account – for dealing, prospectively, with the highly volatile and potentially significant expenses of remediating storm damage. Finally, as previously explained, the Settlement specifies a rate of return on equity for purposes of calculating future smart meter and DSIC revenue requirement, which avoids possible future controversies over that issue and provides a benchmark return rate based on TUS’s transparent method and well-documented data base.

³³ *Bluefield, supra.*

Moreover, the careful balance of interests achieved by the Settlement avoids what could have been a significant expenditure of time, money and other resources by the parties and the Commission to individually resolve a number of issues and proposed adjustments that have now been subsumed by the inter-related compromises that led to the Settlement. Those savings are in everyone's interest and, in themselves, are another important reason why the Settlement promotes the public interest.

B. Revenue Allocation And Rate Design (Joint Petition, Paragraph 11.B.)

As required by the Commission's filing requirements, the Company prepared and submitted a fully-allocated class cost of service study ("COS study"), which was sponsored by Hillary E. Stewart (Penn Power Exhibits HES-1 and HES-2). The Company's COS study followed the basic steps prescribed by the *Electric Utility Cost Allocation Manual* published by the National Association of Regulatory Utility Commissioners ("NARUC") ("NARUC Manual") for arranging accounting data into a format that facilitates allocating or assigning the total cost of service to individual rate schedules or service classifications within an electric utility's rate structure (*see* Penn Power St. 5, pp. 3-4). In so doing, Ms. Stewart applied cost of service practices and procedures that closely aligned with those that were expressly approved by the Commission in PPL's most recent, fully litigated distribution rate case,³⁴ as affirmed by other parties in this case (*see* OSBA St. 1A, pp. 7-8). Consistent with the directives of the NARUC Manual and the Commission's 2012 PPL decision, Ms. Stewart employed a minimum system approach to identify the customer-related component of distribution property recorded in Accounts 364, 365, 366 and 367 (poles, overhead conductors, underground conduit and

³⁴ *Pa. P.U.C. v. PPL Electric Utilities Corp.* Docket No. R-2012-2290597 (Final Order entered December 5, 2012), pp. 105-114.

underground conductors) and allocated remaining costs in those accounts in proportion to class demands measured by each class's non-coincident peak demand (Penn Power St. 5, pp. 11-14).

A number of parties took issue with one or more subsidiary elements of the Company's COS study. As Ms. Stewart explained (Penn Power Sts. 5-R and 5-SR), none of the revisions and refinements other Joint Petitioners proposed had a material impact on the results of the COS study for purposes of determining a reasonable revenue allocation, with the exception of OCA witness Clarence Johnson's proposal not to employ the results of the minimum system study and, instead, to allocate all costs of poles, conduit and conductors in proportion to class demands (*see* OCA St. 3, pp. 9-25). However, as Ms. Stewart and other witnesses explained, Mr. Johnson's proposal directly conflicted with the Commission's decision on the same issue in its Final Order (pp. 106-113) in PPL's 2012 base rate case, where Mr. Johnson made similar arguments that were rejected by the Commission.

Revenue Allocation (Joint Petition, Paragraph 11.B.1). Although the Joint Petitioners could not agree to accept either the Company's COS study or the alternatives proposed by other parties, they all acknowledged that a COS study should be used as a guide, that rates should be designed to move all classes closer to their indicated cost of service, and that the Commission has long recognized that the movement toward cost of service should be tempered by the concept of gradualism in order to avoid large, disruptive, one-time increases to any particular customer class. That was the approach the Company employed to develop its proposed revenue allocation and rate design in this case, as explained by Penn Power witness Kevin M Siedt (Penn Power St. 4, pp. 10-12).

The allocation of the revenue increase among customer classes proposed by witnesses for the various parties did not – with the possible exception of the OCA’s proposal³⁵ – differ materially from each other or from the Company’s proposed allocation (*see* Penn Power St. 4-R, pp. 15-16). Nonetheless, the allocation of the revenue increase under the Settlement Rates was subject to careful consideration and detailed negotiations among the Joint Petitioners. As a result, the Joint Petitioners were able to reach agreement on the allocation among customer classes of the revenue increase under the Settlement Rates that is depicted in Exhibit 3 to the Joint Petition. That allocation is within the range proposed by the Joint Petitioners. Moreover, it provides for reasonable movement toward the system average rate of return by the various customer classes as measured by the Company’s COS study. Accordingly, the revenue allocation effected by the Settlement Rates and depicted in Exhibit 3 is consistent with the Commonwealth Court decision in *Lloyd v. Pa. P.U.C.*, 904 A.2d 1010 (Pa Cmwlth. 2006). Moreover, as the Commonwealth Court recognized in pre-*Lloyd* decisions, which were not disturbed by its holding in *Lloyd*, “there is no single cost of service study or methodology that can be used to answer all questions pertaining to costs”³⁶ nor is there any “set formula for determining proper ratios among rates of different customer classes.”³⁷

Rate Design (Joint Petition, Paragraph 11.B.1). The Joint Petitioners’ litigation positions regarding rate design differed somewhat from each other and from the Company’s proposed rates. The principal area of disagreement related to the level of customer charges and, in particular, the customer charges for the Residential class. As explained by Penn Power’s

³⁵ The OCA was a partial outlier because its witness proposed a revenue allocation based on his alternative COS study that, contrary to the Commission’s directives in the PPL’s 2012 base rate case, ignored the customer components of distribution infrastructure in Accounts 364-367.

³⁶ *Executone of Philadelphia, Inc. v. Pa. P.U.C.*, 415 A.2d 445, 448 (Pa. Cmwlth. 1980).

³⁷ *Peoples Natural Gas Co. v. Pa. P.U.C.*, 409 A.2d 446, 456 (Pa. Cmwlth. 1979).

witness, Mr. Siedt, Penn Power’s proposed customer charge for the Residential class was supported by the same type of customer cost analysis that the Commission approved in PPL’s 2012 base rate case as the basis for the customer charges it adopted there (Penn Power St. 4-R, pp. 3-4 and Penn Power Ex. KMS-9). As part of the Settlement, the Joint Petitioners have agreed that the Residential customer charge should be \$10.85 per month in lieu of a charge of \$12.71 per month proposed by the Company. All of the rate design elements relevant to the design of the Settlement Rates that differ from the rate design proposed by the Company are set forth in Exhibit 4 to the Joint Petition.

The revenue allocation and rate design provisions of the Settlement are reasonable and in the public interest. Every rate proceeding consists of two parts. First, the overall revenues to which a utility is entitled must be determined. The second part of the process must determine how much of the total revenue requirement each rate class should bear. The allocation of revenue responsibility is one of the most contentious parts of a rate proceeding because it is a “zero sum” exercise among the non-utility parties – any revenue responsibility not borne by a particular rate class must be borne by one or more other rate classes. While cost of service studies are the touchstone for reasonable allocations of revenue responsibility among rate classes,³⁸ the Commission has often stated that cost of service analyses must reflect the exercise of judgment and are as much a matter of art as of science.³⁹ For that reason, Pennsylvania appellate courts have repeatedly held that the Commission, in crafting a reasonable rate structure, is “invested with a flexible limit of judgment” and may establish just, reasonable and non-discriminatory rates within a “range of reasonableness.”⁴⁰

³⁸ See *Lloyd v. Pa. P.U.C.*, *supra*.

³⁹ See *Pa. P.U.C. v. Phila. Suburban Water Co.*, 75 Pa. P.U.C. 391, 440 (1991).

⁴⁰ *U.S. Steel Corp. v. Pa. P.U.C.*, 37 Pa. Cmwlt. 173, 187, 390 A.2d 865, 872 (1978).

Thus, establishing a reasonable revenue allocation requires a careful balancing of the countervailing interests of the non-utility parties representing the various customer classes. Accordingly, this aspect of a rate proceeding is particularly well suited to achieving a reasonable overall outcome based on the give-and-take of the settlement process. That is precisely what occurred in this case, which resulted in a complete settlement of all contested issues involving revenue allocation and rate design among a wide array of parties representing the interests of residential, commercial and industrial customers.

While settlement negotiations among parties representing a wide array of customer and stakeholder interests can, in itself, assure a reasonable outcome, the revenue allocation under the Settlement Rates also comports with well-accepted ratemaking principles. As previously explained, although all parties could not agree on a single cost of service study, the parties are in general agreement that the Settlement Rates make appropriate progress in moving all classes closer to their cost of service consistent with the principle of gradualism.

With respect to rate design, the Settlement Rates reflect the need to recover the customer component of total cost of service in the customer charge, while recognizing that increases in the customer charges can impact low-usage customers. Accordingly, the Settlement Rates provide for an increase in the Company's residential customer charge, but in a lesser amount than the customer charge the Company originally proposed. The residential customer charge under the Settlement Rates has the agreement of the OCA, as the party representing residential customers.

For all the foregoing reasons, the proposed revenue allocation and rate design are reasonable, appropriately balance the interests of all parties, and are in the public interest.

C. Uncollectible Accounts Expense and Universal Service (Joint Petition, Paragraph 11.C.)

Uncollectible Accounts Expense (Joint Petition, Paragraph 11.C.1). In the proceeding on its 2011 Default Service Program, the Commission entered a Final Order requiring Penn Power to fully unbundle from its distribution rates uncollectible accounts expense related to its provision of default service for residential, commercial and industrial customers. Since January 1, 2011, uncollectible accounts expense associated with the provision of default generation service and electric generation supplier (“EGS”) service that is billed by the Company has been removed from its distribution rates and recovered under its Default Service Support Rider on a non-bypassable, non-reconcilable basis (Penn Power St. 7, p. 3). Penn Power’s most recent Default Service Program proceeding concluded with a settlement approved by the Commission’s Final Order at P-2013-2391372 entered July 24, 2014. In that settlement, it was agreed that, effective June 1, 2015, Penn Power would recover the uncollectible accounts expense associated with providing hourly-priced default service to industrial customers through default service rates established under its Hourly Pricing Default Service Rider rather than its Default Service Support Rider. *Id.* at 4. No party opposed Penn Power’s proposal to make this change. Paragraph 11.C.I of the Joint Petition sets forth the amounts of uncollectible accounts expense to be recovered under the Riders and in base rates and identifies exhibits to the Joint Petition detailing how those amounts were derived.

Universal Service (Joint Petition, Paragraph 11.C.2). Penn Power has in place a Customer Assistance Plan (“CAP”) that has been approved by the Commission. Under the CAP, qualifying low-income customers receive credits (“CAP Credits”) that reduce the amount they pay for current electric service in order to make that service more affordable. In addition, CAP customers who have unpaid arrearages that pre-date their participation in the CAP and who make

full and timely payment of their current, credit-adjusted bills, have their pre-program arrearages eliminated over time by the phased application of Pre-Program Arrearage Forgiveness Credits (“Forgiveness Credits”). The Company recovers its CAP costs, including CAP Credits and Forgiveness Credits, under its Commission-approved Universal Service Charge (“USC”) Rider.

OCA witness Roger D. Colton (OCA St. 4) submitted testimony in which he contended that: (1) as additional customers were added to the Company’s CAP above current participation levels, the portions of those customers’ bills offset by CAP Credits and Forgiveness Credits, will, in effect, be recovered from all other residential customers; (2) that non-CAP customers have lower uncollectible accounts expense and pay their bills in a more timely basis than CAP customers; and (3) therefore, the increase in CAP participation level, while increasing total CAP Credits and Forgiveness Credits, will have the effect of reducing somewhat the Company’s uncollectible accounts expense and cash working capital requirements. Based on those contentions, Mr. Colton proposed that there should be a predetermined offset applied to the cost of CAP Credits and Forgiveness Credits claimed for recovery in the future under the Company’s USC Rider with respect to future increases in CAP participants above a baseline level. The Company submitted rebuttal testimony disputing both Mr. Colton’s underlying theory and his calculation of a proposed offset (Penn Power St. 3-R, pp. 11-14; Penn Power St. 6-R, pp. 7-9).

Under the Settlement, the Joint Petitioners have agreed to a resolution of this issue such that the CAP Credits and Forgiveness Credits will be offset by 14.3% for each new CAP participant above a baseline of 5,700 participants. This provision will apply to future changes in the USC Rider rate and has no impact on the Settlement Rates.

The uncollectible accounts expense and Universal Service provisions of the Settlement are reasonable and in the public interest. The uncollectible accounts expense

provisions of the Settlement implement clear directives from prior cases, were not opposed by any party and, therefore, are prima facie in the public interest.

The Universal Service provisions affirm the importance of the Company's Universal Service programs as an efficient means of helping low-income customers deal with the cost of electric service. The costs of the bill credits and arrearage forgiveness afforded CAP participants are borne by all the Company's residential customers. The Settlement provides carefully crafted provisions for an "offset" of Universal Service costs to reflect savings in uncollectible accounts expenses and cash working capital expected to occur by reason of future increases in the number of CAP participants. Thus, the Settlement promotes the public interest by providing a reasonable means of continuing the Company's CAP program while mitigating somewhat the costs of that program that are borne by all residential customers.

D. Customer Service And Operations (Joint Petition, Paragraph 11.D.)

Through its witness, Charles V. Fullem, Penn Power asked the Commission to recognize, through an increment to its allowed return on equity, the Company's efforts to control O&M expenses (which, as previously explained, helped extend the period since its last base rate case), its overall management efficiency, its focus on customer service, its dedication to maintaining and enhancing reliability, and its support of Pennsylvania's competitive retail energy market (Penn Power St. 1, pp. 11-20, 25-26). In that regard, Mr. Fullem catalogued the major initiatives the Company had undertaken since 2006 to improve customer service and enhance or maintain reliability,⁴¹ which consisted of the following:

Integration of three call centers. Between the completion of the FirstEnergy/GPU merger and 2007, two call centers were operating independently to serve the customers of

⁴¹ The Company's efforts to contain expenses and its significant investment in reliability-related infrastructure were explained in detail in Section II.A, *supra*.

FirstEnergy's utility subsidiaries. One call center served CEI, Ohio Edison, Penn Power and Toledo Edison customers, and another served Met-Ed, Penelec, and JCP&L customers. In 2007, after careful review and detailed planning, FirstEnergy integrated the technology and operations of the two call centers, which increased efficiencies and enabled a number of service enhancements including:

- Increasing from 200 to 400 the number of agents that could take outage, move-in and move-out calls at a given time;
- Improving call routing to reduce wait times and reduce "busy outs" that occur when the capacity of a call center has been reached or exceeded;
- Increasing business continuity/disaster recovery capabilities;
- Adopting uniform technology for monitoring and reporting performance to ensure that call volumes, call types, service levels, agent performance, busy outs, and other metrics were calculated uniformly and could be meaningfully compared and assessed;
- Standardizing the flow of calls to decrease average handling time and improve the quality of customers' experience.

Penn Power St. 1, pp. 13-15.

In 2011, Allegheny Energy's merger with FirstEnergy added the call center serving West Penn and Allegheny Energy's other utility subsidiaries. In 2012, FirstEnergy integrated the technology and operations of the former Allegheny Energy call center with its two other call centers, which built upon the efficiencies and service enhancements described above. Because of the integration of the technology and operations of multiple call centers, Penn Power was able to answer 80% of all the calls it received within 30 seconds in three of the last four years. *Id.* at 16. Comparable improvements were achieved by other FirstEnergy Pennsylvania subsidiaries as a result of the integration. *Id.*

Enhanced communication during major storms. The Company has materially enhanced communication with customers, local governments, emergency service providers and

first responders during major storm events by adopting and effectively using social media and internet-based access to storm and restoration-related information. For the second year in a row, FirstEnergy's mobile-optimized website and smart phone "app" have been recognized among the top performers in a customer satisfaction survey conducted by J.D. Power. Specifically, in J.D. Power's 2014 Utility Website Evaluation Study, FirstEnergy received the third highest score for overall customer satisfaction when its utility subsidiaries' websites were viewed from a mobile device (FirstEnergy's mobile website and smart phone app for Apple® iPhone® and Android™ devices received a score of 425 out of 500 points). FirstEnergy also was among the top three performers for mobile websites in J.D. Power's 2013 study. In 2013, the number of customers visiting the FirstEnergy website(s) via a smart phone or tablet tripled over the previous year, which is why FirstEnergy is continuing to make it easier to manage electric accounts and report power outages using mobile tools. *Id.* at 16-17.

Recognition for customer service. The Company, as part of the FirstEnergy family of utilities, was recognized by the Edison Electric Institute's National Key Accounts Customer Advisory Group for providing outstanding customer service in 2014. This is the second time FirstEnergy received honors in this category, having won similar recognition in 2006. In addition, Penn Power has on average seen a five percent increase in overall customer satisfaction between 2010 and 2014 as measured by the J.D. Power 2014 Electric Utility Residential Customer Satisfaction Study released July 16, 2014 when compared to the same study in 2010. The Company earned a score that was above its segment average in the J.D. Power 2014 Electric Utility Residential Customer Satisfaction Study. *Id.* at 17.

Customer referral programs. The Company, in conjunction with its affiliated utilities in Pennsylvania, has successfully implemented a customer referral program that, since its

implementation in August 2013, has enrolled over 100,000 residential and small commercial customers with competitive retail suppliers. *Id.* at 17-18.

Portable CAP benefits. The Company has offered fully portable CAP benefits since generation rate caps have expired, which has enabled its low income customers to access competitive retail electric markets while preserving their ability to take full advantage of the benefits available under the Company's Universal Service programs, regardless of their shopping status.

Maintaining reliable electric service. The Company has made system enhancements and implemented specific initiatives designed to enhance reliability and provide customers high-quality, dependable service. The Company presented data showing its performance measured by System Average Interruption Duration Index ("SAIDI"), System Average Interruption Frequency Index ("SAIFI") and Customer Average Interruption Duration Index ("CAIDI") relative to the Commission's benchmark and to the twelve-month standard for each of the reliability indices. *Id.* at 18-19. Over the last five years, the Company's reliability metrics have been better than the Commission's twelve-month standard in 94% of the comparisons and better than the Commission's Benchmark in 32% of the comparisons. *Id.*

OCA witness Barbara R. Alexander submitted testimony that addressed Penn Power's reliability of service and customer service, including call center performance, estimated billing policies, complaint handling and other metrics tracked by the Commission (OCA St. 5). In large part, Ms. Alexander's testimony was intended to try to rebut the testimony of Mr. Fullem. The Company submitted extensive evidence demonstrating that it had provided, and continues to provide, safe, reliable and efficient service that complies with and, in fact, exceeds in quality the requirements of applicable Commission regulations. *See* Penn Power Sts. 11-R and 11-S. At the

same time, the Company explained that it is committed to a goal of continuous improvement and accepted the challenge of improving performance in all aspects of its service. Through the course of settlement negotiations, the Company and the OCA reached agreement on the following series of carefully crafted provisions that address customer service and operations in a meaningful way to the benefit of customers:

Call Center Performance (Joint Petition, Paragraph 11.D.1). The Company agrees to achieve and maintain a rate, calculated on an annual basis, of answering at least 80% of customer calls within thirty seconds, beginning with the twelve-month period ending December 31, 2016.

Residential Disputes – Responses (Joint Petition, Paragraph 11.D.2). The Company agrees to reduce the number of residential disputes that do not receive a response within thirty-days to no more than sixty, beginning with the twelve-month period ending December 31, 2016.

Reliability Metrics and Reporting (Joint Petition, Paragraphs 11.D.3 and 11.D.4). The Company agrees to take necessary actions to: (i) consistently meet the twelve-month performance standards established by the Commission for SAIFI, SAIDI and CAIDI by the end of the first reporting quarter of 2016 (i.e., March 31, 2016); (ii) consistently meet the three-year performance standards established by the Commission for SAIFI, SAIDI, and CAIDI by the end of the calendar year 2017; and (iii) to continue to strive to achieve reliability performance that is at or better than the performance benchmarks applicable to the Company established by the Commission. However, the Settlement does not preclude the Company from requesting through normal Commission procedures that the Commission revise its Standard Benchmark metrics. Additionally, in each calendar year until the Company files its next base rate case where the performance standards are not met by the Company, the Company agrees to provide a report to the statutory parties and IBEW discussing the reasons for the performance failure and outlining

corrective actions the Company will take to achieve the missed performance standard. The Company agrees to convene a collaborative to discuss the corrective actions and to receive additional input if such a collaborative is requested by the statutory advocates.

Meter Reading and Estimated Bills. The Settlement contains the following series of provisions dealing with meter reading and estimated bills:

(Joint Petition, Paragraph 11.D.5). The Company will continue its policies and procedures to read meters at least every month.

(Joint Petition, Paragraph 11.D.6) The Company shall document the specific basis for not issuing a bill based on an actual meter reading each month, if that occurs. The documentation shall categorize the reasons for not reading the meters at least each month and provide total numbers of such missed reads by applicable category. The Company shall provide this documentation through an annual report to be submitted to the statutory advocates on or before March 31 of each year until the Company files its next base rate case.

(Joint Petition, Paragraph 11.D.7) The Company shall revise its website and customer education materials within ninety days of the entry of a Final Order approving the Settlement in this proceeding to explicitly inform its customers, in plain language, of the Company's standard policy to issue bills based on actual meter readings every month. The Company's website shall also explain, in plain language, that customers may provide actual readings in months when the Company might otherwise provide an estimated monthly bill and the procedure for self-readings.

(Joint Petition, Paragraph 11.D.8) The Company shall provide its estimated billing algorithm in use at the time of the Settlement to the statutory advocates and furnish Company personnel to answer questions about the operation of the algorithm. The Company

shall also audit the accuracy and performance of the new algorithm and provide a report of its accuracy, and any modifications if necessary, within ninety days of the conclusion of the first full year of utilizing the modified algorithm.

The customer service and operations provisions of the Settlement are reasonable and in the public interest. The customer service and operations provisions of the Settlement are an excellent example of the way a settlement can promote the public interest by affording parties the flexibility to design creative and innovative solutions that may not have been possible through litigation. Specifically, the Settlement provides for an inter-related series of commitments by the Company to measure its performance in a number of areas against agreed service metrics and to implement policies and procedures designed to enhance customer service and reliability. Among these commitments are a series of provisions addressing issues surrounding the Company's meter reading, use of estimated bills, its estimation process and customer education related to those matters. Each of these provisions has been developed in collaboration with the OCA and its expert, Ms. Alexander, who has consulted in this area for many years and is a former state public utility commissioner. The Settlement sets important goals that will enhance customer service, reliability and operations in a meaningful way to the benefit of all customers and, for that reason among others, promotes the public interest.

E. Smart Meters And Energy Efficiency (Joint Petition, Paragraph 11.E.)

Smart Meters (Joint Petition, Paragraph 11.E.1). In an earlier proceeding related to the Company's Smart Meter Deployment Plan, the Commission directed Penn Power to provide information on cost savings measures achieved from the deployment of smart meters and an explanation of how cost savings will be calculated in future SMT-C rate filings. *See* Docket No. M-2013-2341993. The Company requested that cost savings measures be addressed in the

Company's next base rate proceeding, instead of its August 1, 2014, annual SMT-C filing. The Company's August 1, 2014 annual SMT-C filing was approved by the Commission's Secretarial Letter issued on December 5, 2014, and its revised SMT-C rate became effective on January 1, 2015 (Penn Power St. 7-R, p. 4).⁴² Accordingly, as part of its August 4, 2014 base rate filing, Penn Power proposed a baseline for purposes of measuring savings achieved from the deployment of smart meters as well as the means for determining how cost savings resulting from smart meter deployment will be identified and flowed through to customers.

In the Suspension Order (p.5), the Commission found that the smart meter cost savings issue should be considered in Penn Power's base rate proceeding, ordering as follows:

That West Penn Power Company's filing at Docket M-2013-2341991, Pennsylvania Electric Company's filing at Docket M-2013-2341994, Pennsylvania Power Company's filing at Docket M-2013-22341993 and Metropolitan Edison Company's filing at Docket M-2013-2341990 regarding how cost saving measures achieved from the deployment of smart meters will be calculated in the SMT-C Rider services be addressed in the general base rate case.

Consistent with its request and the terms of the Suspension Order, the Company submitted cost baselines for calculating savings from smart meter deployment. The baselines were provided as Penn Power Exhibit LWG-3. The manner in which the baselines were developed and will be used in future SMT-C calculations was explained in detail in the direct testimony of Laura W. Gifford (Penn Power St. 7, pp. 11-16).

No party submitted any testimony regarding the baselines proposed by the Company, and all of the Joint Petitioners are in agreement that the Company's proposed baselines should be approved without modification. Accordingly, Paragraph 11.E.1 of the Joint Petition sets forth

⁴² As previously explained, when the Settlement is approved and the Settlement Rates become effective, the SMT-C will be reduced to zero, in light of the roll-in to base rates of Smart Meter revenue requirement, subject to a possible future implementation of an SMT-C rate, pursuant to the terms of the Settlement (Joint Petition Paragraph 11.A.2). See Penn Power St. 7-R, pp. 3-4.

that agreement and provides that, for purposes of measuring savings achieved from the Company's deployment of smart meters, a cost baseline will be set as of April 30, 2016 from which savings will be measured for the following categories: (1) meter reading; (2) meter services; (3) back-office; (4) contact center; (5) theft of service; (6) revenue enhancements; (7) distribution operations; and (8) load research. Paragraph 11.E.1 further provides that savings in an additional category, "avoided capital costs," will be measured using March 31, 2014 as the baseline from which to calculate savings. The cost savings baselines shall be those set forth in Penn Power Exhibit LWG-3, which is appended to the Joint Petition as Exhibit 7.

Smart Meter Reporting Metrics and Energy Efficiency Issues (Joint Petition, Paragraph 11.E.2 and Paragraph 11.E.3). EDF and PennFuture submitted the testimony of Dick Munson regarding: (i) customer and authorized third parties' access to energy usage data; and (ii) additional environmental and performance metrics. The same parties also submitted the testimony of Ronny Sandoval, who discussed integrated volt/VAR⁴³ control and integrated resource planning.

In response to Mr. Munson, the Company submitted the rebuttal testimony of George L. Fitzpatrick, who is an independent consultant who was deeply involved in the preparation and implementation of the Company's Smart Meter Plans (Penn Power St. 12-R). Mr. Fitzpatrick explained that virtually all of the recommendations made by Mr. Munson involved matters that were already addressed in the Commission's Smart Meter Implementation Order⁴⁴ or in Company-specific orders approving Penn Power's Smart Meter Procurement and Installation

⁴³ VAR is the acronym for "volt-ampere reactive" and is the measure of reactive power.

⁴⁴ *Smart Meter Procurement and Installation*, Docket No. M-2009-2092655 (Order entered June 24, 2009) ("Implementation Order").

Plan,⁴⁵ its Smart Meter Deployment Plan,⁴⁶ and its Revised Smart Meter Deployment Plan.⁴⁷

With respect to Mr. Sandoval, the Company explained that a base rate proceeding is not the most appropriate forum for addressing the matters he discussed.

As part of the Settlement and in response to Mr. Munson's testimony, the Company agreed to add the following reporting metrics to its Annual Progress Report under its Smart Meter Technology Procurement and Installation Plan filed at Docket No. M-2013-2341990:

- Home area network ("HAN") devices: Number of utility AMI meters with consumer devices registered to operate with the HAN chip.
- AMI meter installs: Number of smart meters installed, number of smart meters that have been installed and registered.
- Customer complaints: Number of formal and informal PUC complaints related to AMI meter deployment, broken down by type of complaint and resolution. AMI meter deployment includes installation, functioning or accuracy of the AMI meter, and HAN device registration.
- Reduction in greenhouse gas ("GHG") emissions: reduction associated with reduced truck rolls associated with meter readings and increased efficiencies. This reporting will commence once the realization of this benefit has been determined and reflected in the smart meter baseline savings as of April 30, 2016.
- Voltage and VAR controls: Number and percentage of distribution lines using sensing from an AMI meter as part of utility's voltage regulation scheme.

Additionally, with respect to the matters discussed by both Mr. Munson and Mr. Sandoval, the Company agreed to host an informational meeting with representatives of EDF with respect to the Company's smart meter and smart grid deployment efforts, including

⁴⁵ *Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan*, Docket No. M-2009-2123950 (Order entered June 9, 2010).

⁴⁶ *Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company For Approval of Their Smart Meter Deployment Plan*, Docket Nos. M-2013-2341990, M-2013-2341991, M-2013-2341993, and M-2013-2341994 (Order entered March 6, 2014).

⁴⁷ *Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company For Approval of Their Smart Meter Deployment Plan*, Docket Nos. M-2013-2341990, M-2013-2341991, M-2013-2341993, and M-2013-2341994 (Order entered June 25, 2014).

discussion of customer data access, Volt/VAR best practices and measuring GHG emission reductions.

The smart meter and energy efficiency provisions of the Settlement are reasonable and in the public interest. The smart meter issues that the Commission transferred to this case relate to setting reasonable baselines for calculating savings from smart meter deployment. Those savings are to be flowed through to customers in the future through the SMT-C Rider. Because the “baselines” involve costs that are recovered in the Company’s base rates, referring the baseline issue to this proceeding was the most efficient way to reach a reasonable conclusion and avoid the possibility of inconsistent results between this case and a separate proceeding dealing solely with the smart meter baselines. Each of those goals is consistent with, and promotes, the public interest. Just as important, after reviewing the Company’s baselines, no party took issue with them and all Joint Petitioners have expressly agreed to their adoption.

The Settlement also provides that the Company will add reporting metrics (as specified in the Joint Petition) to its Annual Progress Report for its Smart Meter Technology Procurement and Installation Plan filed at Docket No. M-2013-2341993. EDF believes that these reporting metrics will help to assess and possibly promote energy efficiency efforts. Additionally, the Company has agreed to host an information meeting with EDF and interested statutory parties on energy efficiency, conservation and related environmental issues. These issues, which might have resulted in complicated litigation if this case were not settled, were resolved in a collaborative fashion through the settlement process. Accordingly, the Settlement efficiently and expeditiously identified a means of satisfying all parties’ interests in a way that continued litigation was unlikely to achieve. For that reason, and because of the inherent merits of the provisions agreed to, these provisions promote the public interest.

F. General Matters (Joint Petition, Paragraph 11.F)

The Joint Petition contains three general terms that pertain to various other terms and conditions of the Settlement, as follows:

(Joint Petition, Paragraph 11.F.1). This term provides that nothing contained in the Joint Petition is intended to limit the authority of the Commission, the Bureau of Consumer Services, the Bureau of Safety and Compliance, or other Bureaus of the Commission from performing their duties.

(Joint Petition, Paragraph 11.F.2). This term provides that nothing in the Settlement terms waives or alters any Joint Petitioner's right to seek from the Commission an audit or investigation of any issues pertaining to the Company's reliability, customer service, or estimated billing or pertaining to evaluating the impact of the reforms recently adopted by the Company and as described by in the rebuttal testimony of Company witness Steven E. Strah (Penn Power Statement No. 11-R).

(Joint Petition, Paragraph 11.F.3). This term provides that the Company agrees that should it have failed to consistently meet the requirements set forth in this Settlement regarding reliability, customer service, or estimated meter reading, it shall not make a request for any return on equity premium award based on reliability or customer service performance in its next base rate case.

(Joint Petition, Paragraph 11.F.4). This paragraph acknowledges that the terms of the Settlement do not encompass all of the changes made to Chapter 14 of the Pennsylvania Public Utility Code, 66 Pa.C.S. § 1401 *et seq.*, by Act 155 of 2014, because the Commission had not provided guidance on how to incorporate Act 155 of 2014 into tariffs at the time this Settlement was negotiated. Therefore, Paragraph 11.F.4 provides that nothing contained in the Settlement

shall preclude the Company from proposing further tariff changes at a later date based on Commission directives or guidance relating to implementing the provisions of Act 155 of 2014, or as otherwise necessary to implement the changes contained in Act 155 of 2014.

The general provisions of the Settlement are reasonable and in the public interest.

The General Matters addressed in Paragraphs 11.F expressly preserve the rights of the Commission, its applicable bureaus and the Joint Petitioners with respect to the areas of responsibility and possible future enforcement actions set forth therein. It also specifically identifies a limitation on the Company's ability to request to augment its return on equity in its next base rate case if it does not consistently meet the requirements set forth in the Settlement regarding reliability, customer service or estimated meter readings. Finally, this section also acknowledges that the Company can make necessary filings to implement the changes contained in Act 155 of 2014 should that become necessary.

III. SUMMARY: THE SETTLEMENT IS IN THE PUBLIC INTEREST

The Settlement, both in its specific terms and viewed holistically, is reasonable, supported by record evidence, and is in the public interest for, among others, the following principal reasons:

- The revenue requirement provisions provide for Settlement Rates that are within the “constitutional range of reasonableness”⁴⁸ and are consistent with the legal standards articulated in the *Bluefield*, *Hope* and *Duquesne Light* decisions, as interpreted and applied by the Pennsylvania Supreme Court in *Pennsylvania Gas and Water*. The Settlement Rates reflect a careful balance of the interests of customers with those of the Company and its investors. As such, the Settlement

⁴⁸ See *Duquesne Light*, *supra*.

Rates protect customers from paying excessive rates while allowing the Company and its investors a reasonable opportunity to earn a fair return on their investment in property devoted to public service and to obtain additional capital needed to meet the Company's service obligations. *See* Section II.E., *supra*.

- The rate structure and rate design provisions of the Settlement resolve a number of contentious issues in a manner that is acceptable to parties representing every major customer class and service classification. While the parties could not agree to a single, specific cost of service methodology, they are in general agreement that the Settlement Rates provide for reasonable progress in moving all major customer classes closer to their cost of service consistent with the Commission-approved principle of gradualism. *See* Section II.F., *supra*.
- The Settlement resolves a contested issue pertaining to Universal Service in a manner that helps to ameliorate the impact on residential customers of the costs of the Company's Universal Service programs. *See* Section II.G., *supra*.
- The Settlement reaches agreement among the Joint Petitioners – and, in particular, between the OCA and the Company – with regard to objective metrics for measuring customer service and reliability performance and contains commitments for implementing policies and procedures designed to enhance customer service and reliability. Among these provisions are specific commitments dealing with meter reading, estimated bills, estimation procedures and customer education related to those matters. *See* Section II.H., *supra*.
- The Settlement addresses and resolves the smart meter baseline issue that the Commission referred to this proceeding. *See* Section II.I., *supra*.

- The Settlement adds reporting metrics intended to provide information that may help to better assess smart meter, energy efficiency, conservation and various environmental matters. *See* Section II.E, *supra*.
- In reaching this Settlement, the Joint Petitioners thoroughly considered all issues, including those related to the Company's reliability and operations, raised in the testimony and evidence presented by the parties to this proceeding and during public input hearings. As a result of that consideration, the Joint Petitioners believe that the Settlement meaningfully addresses all such issues raised and, therefore, should be approved without modification.
- All of the foregoing benefits are achieved while also conserving the time, resources and money that would otherwise have to be expended if this case were to be fully litigated. Customers are direct beneficiaries of these savings.

IV. CONCLUSION

For the reasons set forth above and in other Joint Petitioners' Statements in Support, the Company submits that the Settlement is a fair and reasonable compromise that is fully supported by the record evidence. Accordingly, the Company respectfully requests that the Administrative Law Judges and the Commission: (1) approve the Settlement without modification; (2) find that the Settlement Rates are just and reasonable; and (3) grant the Company permission to file the tariff attached to the Joint Petition as Exhibit 1 to become

effective no later than May 19, 2015 for service rendered on and after May 3, 2015, subject to the recoupment surcharge for lost revenues described in the Joint Petition.

Respectfully submitted,



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Counsel for Pennsylvania Power Company

Dated: February 3, 2015

Statement B

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket Nos. R-2014-2428744
	:	M-2013-2341993
Pennsylvania Power Company	:	

STATEMENT OF THE OFFICE OF CONSUMER
ADVOCATE IN SUPPORT OF THE JOINT
PETITION FOR PARTIAL SETTLEMENT

The Office of Consumer Advocate (OCA), one of the signatory parties to the Joint Petition for Partial Settlement (Settlement), finds the terms and conditions of the Settlement to be in the public interest for the following reasons:

I. INTRODUCTION

On August 4, 2014, the Pennsylvania Power Company (Penn Power or the Company) filed Tariff Electric – Pa. P.U.C. No. 36, at Docket No. R-2014-2428744, to become effective October 3, 2014. Penn Power serves approximately 162,000 residential, commercial, and industrial customers in all or portions of six counties in northern and central Pennsylvania.

The Company sought Commission approval of rates and rate changes that would modify existing tariff provisions and increase the level of rates that Penn Power charges for providing electric distribution service to its customers. If Tariff No. 36 had become effective as proposed, the Company would have had an opportunity to recover an estimated annual increase in distribution revenues of \$29.6 million based on a fully projected future test year ending April 30,

2016, or an approximate increase of 8.7% on a total revenue basis over the Company's present rates. As part of this increase, the Company proposed to increase the residential monthly customer charge from \$8.86 to \$12.71.

On September 5, 2014, the OCA filed a Formal Complaint against the proposed distribution rate increase and submitted its Public Statement as to the proposed distribution rate increase. Numerous other parties filed Petitions to Intervene or Formal Complaints against the proposed distribution rate increase, including: the Bureau of Investigation and Enforcement (I&E); the Office of Small Business Advocate (OSBA); Citizens for Pennsylvania's Future (PennFuture) and Environmental Defense Fund (EDF); the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania (CAUSE-PA); the Pennsylvania State University (PSU); Wal-Mart Stores East, LP and Sam's East, LP (Walmart); and Noble Americas Energy Solutions, LLC (Noble) (collectively, the Joint Petitioners).

On October 2, 2014, the Commission suspended the Company's proposed tariff supplement pending investigation. The proceeding was assigned to the Office of Administrative Law Judge and specifically assigned to Administrative Law Judge Dennis J. Buckley (ALJ Buckley) and Administrative Law Judge Katrina L. Dunderdale (ALJ Dunderdale). On October 8, 2014, ALJ Buckley and ALJ Dunderdale held an initial prehearing conference in this matter. On October 22, 2014, ALJ Buckley and ALJ Dunderdale issued a prehearing order establishing a procedural schedule and also setting forth certain modifications to the Commission's regulations regarding discovery matters. Public Input Hearings were convened in this matter in the following locations: Warren, New Castle, Erie, Washington, Uniontown, East Stroudsburg, and Reading in November 2014.

In accord with the procedural schedule established for this matter, on November 24, 2014, the OCA submitted the Direct Testimonies of: Ralph C. Smith,¹ OCA Statement No. 1; Marlon F. Griffing, Ph.D.,² OCA Statement No. 2; Clarence L. Johnson,³ OCA Statement No. 3; Roger D. Colton,⁴ OCA Statement No. 4; and Barbara R. Alexander,⁵ OCA Statement No. 5. On December 18, 2014, the OCA submitted the Rebuttal Testimonies of Ralph C. Smith, OCA Statement No. 1R, and Clarence L. Johnson, OCA Statement No. 3R. On January 6, 2015, the OCA submitted the Surrebuttal Testimonies of: Ralph C. Smith, OCA Statement No. 1SR; Marlon F. Griffing, Ph.D., OCA Statement No 2SR; Clarence L. Johnson, OCA Statement No.

¹ Mr. Smith is a Senior Regulatory Consultant at Larkin & Associates, PLLC in Livonia, Michigan. He provides consulting and expert witness services regarding rate cases and regulatory filings on behalf of industry, state attorneys general, consumer groups, municipalities, and public service commission staff. Mr. Smith is also a licensed C.P.A. and attorney in Michigan. A complete description of Mr. Smith's qualifications is provided in OCA Statement No. 1, Attachment RCS-1.

² Mr. Griffing is a Senior Consultant at Snavely King Majoros & Associates, Inc., an economic consulting firm located in Landover, Maryland. He is a principal investigator and expert witness regarding capital structure, cost of capital, cost of equity, overall rate of return, rate design, and other related issues. He has a Ph.D., M.A., and B.A. in Economics from the University of Nebraska – Lincoln. Mr. Griffing's qualifications are detailed in OCA Statement No. 2, Attachments A and B.

³ Mr. Johnson is a consultant located in Austin, Texas, providing technical analysis, advice, and expert testimony regarding energy and utility regulatory issues. His clients have included state consumer advocate offices, customer groups, and coalitions of municipalities in Texas. Mr. Johnson has over 30 years of experience as a utility regulatory expert, including 25 years as Director of Regulatory Analysis for the Texas Office of Public Utility Counsel (OPC). A more detailed description of Mr. Johnson's qualifications is included in OCA Statement No. 3, Appendix A.

⁴ Mr. Colton is a Principal of Fisher Sheehan & Colton, Public Finance and General Economics in Belmont, Massachusetts. He provides technical assistance to public utilities and primarily works on low income utility issues. Mr. Colton has devoted his professional career to helping public utilities, community-based organizations and state and local governments design, implement and evaluate energy assistance programs to help low income households better afford their home energy bills. He has been involved with the development of the vast majority of ratepayer-funded affordability programs in the nation. A more complete description of Mr. Colton's education and experience is provided in OCA Statement No. 4, Attachment A.

⁵ Ms. Alexander is a Consumer Affairs Consultant who works on consumer protection and customer service issues associated with utility regulation. Ms. Alexander is an attorney and a graduate of the University of Michigan and the University of Maine School of Law. Prior to opening her consulting practice in 1996, she spent nearly ten years as the Director of the Consumer Assistance Division of the Maine Public Utilities Commission. Her current consulting practice is directed to consumer protection, customer service and low-income issues associated with both regulated and retail competition markets. Ms. Alexander's qualifications are detailed in OCA St. No. 5, Exhibit A.

3SR; Roger D. Colton, OCA Statement No. 4SR; and Barbara R. Alexander, OCA Statement No. 5SR.

The testimonies of OCA witnesses Smith, Griffing, Johnson, Colton, and Alexander, as identified above, were entered into the record by stipulation of the parties at the hearing on January 14, 2015. Prior to the hearing, the Parties entered into a settlement in principle on all issues except for LED lighting issues raised by PennFuture. Cross examination of all witnesses was waived by all Parties, and the outstanding LED lighting issue will be briefed by the Company and PennFuture.

Pursuant to the Commission's policy of encouraging settlements that are in the public interest, the Joint Petitioners held numerous settlement discussions. These discussions resulted in this Settlement, which addresses numerous complex issues raised in this case. The OCA submits that the Settlement is in the public interest and in the best interest of Penn Power's ratepayers and should be approved without modification.

The terms and conditions of the Settlement satisfactorily address issues raised in the OCA's analyses of Penn Power's filing. The OCA submits that this Settlement, taken as a whole, is a reasonable compromise in consideration of likely litigation outcomes before the Commission. While the Settlement does not reach all the recommendations proposed by the OCA, the OCA recognizes that the Settlement is a product of compromise. The Commission encourages settlement, and the balance of compromises struck by settling parties is critical to achieving settlement. Accordingly, the OCA urges the Commission to consider the Settlement as a whole.

In this Statement in Support, the OCA addresses those areas of the Settlement that specifically relate to important issues that the OCA raised in the case. The OCA would expect

that other parties will discuss how the Settlement's terms and conditions address their respective issues and how those parts of the Settlement support the public interest standard required for Commission approval.

For these reasons, and those that are discussed in greater detail below, the OCA submits that the Settlement is in the public interest and the best interest of Penn Power's ratepayers, and should be approved by the Commission without modification.

II. REVENUE REQUIREMENT (Settlement ¶ 11(A))

As stated above, in its filing the Company proposed to increase its total annual operating revenues by approximately \$29.6 million, or 8.7% on a total revenue basis (distribution, transmission, and generation). After reviewing the Company's filing, the OCA recommended an annual operating revenue increase of approximately \$3.181 million. OCA St. No. 1 at 8. I&E recommended that the Company receive an increase of approximately \$13.865 million. I&E St. No. 2 at 63-64. Under the Settlement, the Company will be permitted an increase in annual operating revenues of \$17 million. Settlement ¶ 11(A)(1). This \$17 million increase is \$12.6 million less than the amount originally requested by the Company. On a total revenue basis (distribution, transmission, and generation), the increase is 5.2% as compared to the original request of 8.7%.⁶

The increase includes revenue related to distribution and smart meters, as well as a storm reserve account that will be created under the Settlement and which is discussed in detail below in Section IV. In its filing, the Company included amortizations of expenses for storm damages that had previously been approved for deferred accounting treatment by the Commission, as well as expenses associated with legacy meters. The Settlement provides for a five-year amortization

⁶ On a distribution revenue only basis, the Company's requested \$29.6 million increase represents a 37.39% increase in distribution revenue. The Settlement increase on a distribution only basis is 21.5%.

period for both deferred storm damage expenses and legacy meter expenses. Settlement ¶¶ 11(A)(3)-(4). The terms of the Settlement provide that the increase will go into effect no later than May 19, 2015. Settlement ¶ 11(A)(1).

The Settlement represents a “black box” approach to all individual revenue requirement and return on equity issues, with the limited exceptions contained in the Settlement relating to smart meter and distribution system improvement charge (DSIC) matters. See Settlement ¶ 11(A)(7). Black box settlements avoid the need for protracted disputes over the merits of individual revenue adjustments and avoid the need for a diverse, large group of stakeholders to attempt to reach consensus on a variety of financial numbers. The OCA submits that it is unlikely that the parties would have been able to reach a consensus on each of the disputed accounting and ratemaking issues raised in this matter, as policy and legal positions can differ widely. As such, the parties have not specified a dollar amount for each issue or adjustment raised in this case. Attempting to reach an agreement regarding each adjustment in this proceeding would have likely prevented any settlement from being reached. However, where it is necessary to reference an ROE for smart meter purposes, the method of establishing an ROE has been agreed upon and is reflected in the Settlement at ¶ 11(A)(7). Under the Settlement, the most recent Commission Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Utilities, Electric Distribution Companies’ Market Based Return on Common Equity (based on DCF methodology), Distribution System Improvement Charge Return will be used to set the ROE for smart meter surcharge purposes.

Based on the OCA’s analysis of the Company’s filing, discovery responses received, and testimony by all parties, the revenue increase under the Settlement represents a result that would be within the range of likely outcomes in the event of full litigation of the case. The increase is

reasonable and yields a result that is in the public interest, particularly when accompanied by other important conditions contained in the Settlement such as Tariff modifications and the customer service, estimated billing, and reliability terms discussed in detail below in Sections VI and VII. The increase agreed to in the Settlement provides adequate funding to allow the Company to improve its customer service and reliability metrics and maintain the safety and adequacy of its distribution system. As such, the OCA submits that the increase agreed to in this Settlement is in the public interest and in the interest of Penn Power's ratepayers, and should be approved by the Commission.

III. REVENUE ALLOCATION AND RATE DESIGN

A. Revenue Allocation (Settlement ¶ 11 B(1); Exh. 3)

The Settlement provides that Penn Power can increase base rates by amounts designed to produce a \$17 million increase in annual operating revenues, in lieu of the increase of \$29.6 million originally proposed by the Company. Settlement ¶ 11(B)(1); Exh. 3. In its filing, Penn Power proposed to allocate \$22.41 million of its proposed \$29.6 million revenue increase request to residential customers. The Company's proposed allocation would have resulted in a 39.48% increase to the residential customer class on a distribution-only basis or 8.7% on a total revenue basis. OCA St. No. 3 at 44. If this request had been approved as filed, a residential customer using 1000 kWh per month would have seen their average total bill rise by \$13.54 per month, from \$104.76 to \$118.30, or approximately 12.93% under the Company's proposal.

Under the Settlement, the residential customer class will receive an overall increase in distribution revenue of \$9.28 million per year or an 18.93% increase.⁷ A residential customer using 1000 kWh per month will see their average total bill rise by \$7.80 per month, from \$104.76 to \$112.56 rather than the \$13.54 per month increase proposed by the Company. This

⁷ On a total revenue basis (distribution, generation, and transmission), this represents a 7.51% increase.

increase is \$5.74 less per month than the increase originally proposed by the Company. On a total monthly bill basis, a customer using 1,000 kWh would see a 7.45% increase rather than the 12.93% increase proposed by the Company.

OCA witness Clarence L. Johnson reviewed the Company's revenue allocation proposal and the Company's class cost of service study (CCOSS) upon which the Company's allocation was based. The OCA contested the Company's CCOSS in this matter and Mr. Johnson submitted a modified CCOSS, which he used in his analysis to develop a recommended allocation of any proposed revenue increase for the Company among its customer classes. See OCA St. No. 3, Schedule CJ-3 (summarizing the results of the Company's CCOSS at current rates with the elimination of the minimum system) and Schedule CJ-4 (summarizing the results of the Company's CCOSS at current rates if the customer classification percentages are adjusted based on Mr. Johnson's alternative recommendation). Based on his CCOSS, Mr. Johnson recommended that the residential class be allocated approximately \$18.55 million of the Company's proposed increase with a proportional scale back should an increase of less than \$29.6 million be authorized. OCA St. No. 3 at 42-44. Under Mr. Johnson's proposed allocation, the residential customers would receive a 33% distribution increase as compared to the Company's proposed 39% distribution rate increase. OCA St. 3 at 44. In addition to the Company and the OCA, I&E, OSBA, MEIUG, and Wal-Mart Stores East and Sam's East also submitted allocation recommendations in their direct testimonies based on the results of their cost of service studies. The allocation proposals varied widely.

Based on the OCA's review of the cost of service studies presented in this proceeding and the varying revenue allocation proposals presented by other parties, the OCA views the Settlement to be within the range of reasonable outcomes that would result from the full

litigation of this case. The Settlement allocation is consistent with moving all classes toward the system average rate of return and is, therefore, in the public interest. That is, the Settlement balances the need to allocate costs according to cost of service with the need to adhere to the ratemaking principle of gradualism. The Settlement allocation represents a compromise of the parties that moves all classes closer to the system average without providing any one class with an allocation that would cause rate shock. The Settlement is therefore reasonable, and when accompanied by other important conditions contained in the proposed Settlement, yields a result that is just and reasonable, in the public interest, and should be approved.

B. Residential Rate Design (Settlement ¶ 11(B)(1); Exh. 4)

The Settlement provides that Penn Power's monthly residential customer charge will increase from \$8.89 to \$10.85, or 22.05%. Settlement ¶ 11(B)(1); Exh. 4. In its filing, the Company proposed increasing the residential customer charge to \$12.71, or an increase of 43%. See OCA St. No. 3 at 34. In his direct testimony, OCA witness Johnson's primary recommendation was that the residential customer charge be set at \$6.80, which is a level consistent with and slightly higher than his benchmark calculation (which is based on Mr. Johnson using a basic customer calculation that does not include a number of indirect costs that are included in the Company's existing customer charge calculation). Based on his direct customer cost calculation, Mr. Johnson recommended that the customer charge be reduced. OCA St. No. 3 at 39-40. Mr. Johnson's alternate recommendation, if the Commission did not find it appropriate to reduce the current customer charge, was to maintain the current charge. OCA St. No. 3 at 40.

The OCA submits that eliminating most of the customer charge increase will benefit residential customers. By providing a customer charge \$1.86 lower than the Company's

proposed charge and recovering the remaining revenue through the energy charges, the energy charges can provide necessary signals to customers regarding conservation. See OCA St. No. 3 at 34.

The OCA submits that the residential rate design established through the Settlement is reasonable and consistent with sound ratemaking principles. Combined with a \$12.6 million lower revenue increase than the Company sought, these rate design changes result in rates that are significantly below the rates originally proposed by the Company and within the range of the likely outcomes in the event of full litigation of the case.

IV. STORM DAMAGE RESERVE ACCOUNT (Settlement ¶ 11(A)(4))

In its filing, the Company proposed to adopt a new Storm Damage Charge Rider (Storm Rider) to recover storm damage expenses. Met-Ed witness Kimberlie Bortz stated that the Storm Rider would “impose a charge or credit on Customers’ bills to reflect the difference, on an annual basis, between the respective storm damage expenses recovered in the Companies’ base rates and the actual storm damage expenses incurred by the Companies.” Penn Power St. No. 3 at 26.

The OCA opposed the creation of a Storm Rider for a number of reasons, as explained by OCA witnesses Alexander and Smith. See OCA St. No. 5 at 66-73; OCA St. No. 1R. The use of a rider to recover costs outside of a base rate case “eliminates the checks and balances associated with a base rate case in which all of the utility’s costs, expenses, and revenues can be considered prior to allowing rates to be set and when a consideration of prudence concerning the utility’s expenditures can be considered.” OCA St. No. 5 at 67-68. The proposed Storm Rider would allow storm expenses to be recovered when incurred, thus removing the incentive to keep costs as low as possible. OCA St. No. 5 at 68. Additionally, as proposed, the Storm Rider would

allow the recovery of all storm expenses, not only those that are “extraordinary” or even “major,” and “would eliminate any obligation of the Company to manage its routine storm costs between rate cases.” Id. Thus, the OCA opposed the proposed Storm Rider.

I&E also opposed Penn Power’s proposed Storm Rider. I&E St. No. 5 at 22. I&E witness Boyd suggested the use of a storm reserve account to allow the Company to self-insure for distribution system storm damage expenses. I&E St. No. 5 at 24. In Rebuttal Testimony, the OCA disagreed with I&E witness Boyd’s proposal because her proposed storm reserve account included a rider mechanism. OCA St. No. 1R at 4. OCA witness Smith explained how any storm reserve account should be structured:

In concept, a storm damage reserve account would function similarly to an Injuries and Damages reserve account that has been used in ratemaking in the past. Expense accruals for storm damage would be recorded to build up a reserve, and costs would be charged against the reserve account when incurred. The reserve account and the level of costs would be reviewed in the utility’s base rate cases. Amounts over or under the funding level in the reserve account are addressed in the subsequent base rate case. There would not be any related surcharge, and the annual accrual amounts would not be adjusted between utility base rate cases. Issues concerning the determination of a normalized amount of storm costs would be addressed in utility base rate cases.

OCA St. No. 1R at 4. Additionally, for any extraordinary storm expenses incurred between rate cases, the Company can submit a petition for deferred accounting for extraordinary storm damage, as has been the practice in Pennsylvania for decades. OCA St. No. 1R at 5.

The Settlement provides for the creation of a storm reserve account that is structured in the way that OCA witness Smith described in his Rebuttal Testimony. The Settlement provides the following:

A Storm Reserve Account will be established and maintained on the Company’s balance sheet beginning on the date the Settlement Rates become effective. The Company’s total revenue requirement includes \$1 million to be recovered for purposes of funding this reserve, which represents a five-year average of historical expenses. Penn Power’s historical expenses for that period did not

include any expenses related to damage from extraordinary storm events which the Company received Commission approval to defer. Expenses related to storm damage, excluding those expenses related to damage from extraordinary storm events, will be recorded in the Storm Reserve Account in order to eliminate any impact of such expenses on the Company's income statement. Expenses related to damage from extraordinary storm events will be accounted for separately in accordance with the current practice of petitioning the Commission for approval to defer such expenses. Both revenues received and costs incurred by the Company in support of other regulated utilities, including other jurisdictional and non-jurisdictional affiliated companies, for assisting during storm events will be reflected in the reserve account.

Settlement ¶ 11(A)(4). This provision addresses the concerns raised by the OCA in that it maintains the checks and balances provided by Commission oversight that would have been removed with the use of the Storm Damage Charge Rider. This method allows the Company to account for storm expenses based on a five-year average of historical storm damage expenses, while continuing to require the Company to petition the Commission for approval for deferral accounting of extraordinary storm damage expenses. For these reasons, the creation of a storm reserve account in the Settlement is in the public interest and should be approved.

V. UNIVERSAL SERVICE AND CUSTOMER ASSISTANCE PROGRAMS (Settlement ¶ 11(C))

The Settlement addresses some of the key concerns raised by OCA witness Colton regarding the Company's proposed cost recovery mechanism for its universal service program. Specifically, Mr. Colton focused on the Company's Universal Service Charge Rider (USC Rider) and explained that as currently structured, the USC Rider would double-recover uncollectible expenses and would allow for the recovery of costs that should be subject to base rate recovery rather than recovery through the Rider. OCA St. No. 4 at 4. Mr. Colton recommended that the Company offset its CAP credits by an amount equal to a percentage of the incremental CAP credits in order to reflect the double-collection of bad debt expenses that would occur if the

Company is permitted to pass 100% of the incremental CAP credits through the USC Rider. OCA St. No. 4 at 7.

Similarly, Mr. Colton noted that the USC Rider would also allow for double-recovery of arrearage forgiveness credits. As Mr. Colton explained, “[t]o allow the dollars of arrearage forgiveness credits to be added to the USC Rider without correspondingly subtracting those dollars from base rates allows the Companies to collect those dollars in *both* places, thus creating the over-collection to which I refer above.” OCA St. No. 4 at 19-20.

Mr. Colton also recommended that working capital offsets be applied to CAP credits and arrearage forgiveness credits that the Company proposes to collect through its USC Rider in order to reflect the fact that billed revenue will only be charged to CAP non-participants who generally have a favorable payment profile, leading to less working capital being associated with the billings. OCA St. No. 4 at 21.

To address these issues, Mr. Colton recommended that, “[f]or any and all CAP customers exceeding the 5,508 participation level on an average annual basis, the Company shall offset the actual CAP Credits by 22.4% and shall offset the actual Pre-program Arrearage Forgiveness Credits by 56.6%.” OCA St. No 4, Sched. RDC-4-PP.

The Settlement provides that:

In the event that the average annual Customer Assistance Plan (“CAP”) participation in the preceding reconciliation year exceeded 5,700 participants, actual costs recovered through Penn Power’s Universal Service Charge (“USC”) Rider shall reflect CAP Credits and actual Pre-Program Arrearage Forgiveness Credits for all customers up to the 5,700 participation level. The Company shall offset the average annual CAP Credits and Pre-Program Arrearage Forgiveness Credits by 14.3% per participant for the preceding reconciliation year for any and all CAP customers exceeding the 5,700 participation level.

Settlement ¶ 11(C)(2).

The OCA submits that this adequately addresses Mr. Colton's concerns regarding the need for offsets to avoid double-recovery of CAP Credits and arrearage forgiveness credits for purposes of this Settlement. The Settlement provisions are therefore reasonable and in the public interest.

VI. TARIFF (Settlement Exh. 1)

In its filing, the Company proposed to re-write its Tariff as presented by Company witness Bortz. See Penn Power St. No. 3. The OCA, through witness Alexander, presented testimony on the issue of the Tariff re-write. Ms. Alexander identified four high-level concerns with the proposed re-write, as follows: 1) the Company sought to eliminate some consumer protections that were more liberal than those under Chapter 56 of the Commission's regulations, 52 Pa. Code § 56.1, *et seq.*; 2) the proposed Tariff was not entirely clear as to whether certain language complies with Chapter 56; 3) the Company's use of the phrase "sole discretion" throughout the proposed Tariff; and 4) the proposed Tariff did not explicitly explain the Company's billing policies relating to estimated billing. See OCA St. No. 5 at 75-76. OCA witness Alexander made recommendations as to these four high-level issues, as well as highlighted specific provisions that should be changed. Her overarching recommendations were as follows: 1) the Company's historic consumer protections should continue; 2) the Chapter 56 references should be more detailed; 3) the phrase "sole discretion" should be removed from the Tariff; and 4) estimated billing policies should be more clearly explained. See OCA St. No. 5 at 75-76.

As part of the settlement process, certain changes were made to Penn Power's Tariff as outlined herein. One overarching revision was made to remove the use of the phrase "sole discretion" throughout the Tariff, with three specific exceptions where it was agreed that the

language appropriately remained. Those three exceptions are found in the following Rules: Rule 7 – Wiring, Apparatus and Inspection; Rule 14 – Individualized Contracts; and Rule 15 – Company Facilities, Services and Products. See Settlement, Exh. 1, Pennsylvania Power Co. Tariff, Electric Pa. P.U.C. No. 35 at Original Pages 35, 49, 50, and 51 (Tariff). The remainder of this section details the specific Rule number in which language was added, deleted, changed, or otherwise revised—based in part on Ms. Alexander’s recommendations—and corresponding explanatory language.

In the “General Application” section, language was reinserted to the Tariff that directs the Company’s customers to where they may inspect the Company’s Tariff. That language now reads as follows:

A copy of this Tariff has been filed with the Pennsylvania Public Utility Commission and is posted and available for inspection at the Company’s offices that are open to the public. A copy of this Tariff and all documents referenced in this Tariff are available on the Company’s Internet Web Page at www.firstenergycorp.com.

Tariff at Original Page 10. This provision was reinserted to provide the Company’s customers with sufficient information to locate and inspect the Company’s Tariff.

In Rule 2, Deposits, language was reinserted stating that the Company will use an accepted credit scoring methodology that is based on utility payment history to determine deposit requirements where an applicant’s/customer’s credit has not been established or has been impaired. The reinserted language reads as follows:

The Company utilizes a generally accepted credit scoring methodology in range of general industry practice that is based on an applicant or customer’s utility payment history.

Tariff at Original Page 23. This provision was reinserted to make clear that any credit scoring must be based on utility payment history.

Additionally, proposed language was deleted that would have been in conflict with 66 Pa. C.S. § 1404(a) and 52 Pa. Code § 56.32(a), which require a utility to establish a cash deposit amount at the time the utility determines a deposit is required (the proposed provision sought to permit the Company to proportionally increase a cash deposit after the initial deposit amount was determined).

In Rule 10, Meter Reading and Rendering of Bills, the language of Rule 10.a(1) was modified to clarify that meter reading for residential customers would be done consistent with Chapter 56 consumer protections. The language was also clarified to reflect the Company's policy to read residential meters on a monthly basis and other customer classes' meters on a quarterly basis. The clarified language reads, in relevant part, as follows:

The Company reserves the right to read meters in all or any part of its service area on quarterly schedules, except as provided for under Chapter 56 of the Commission's regulations and to render standard bills for the recorded use of service based upon the time interval between meter readings.

Tariff at Original Page 39. These clarifications provide residential customers with clear information that permits them to understand the Company's meter reading policies and assurances that those policies comply with the Commission's consumer protections under Chapter 56.

Also in Rule 10, the language of Rule 10.b(1) was modified to clarify the Company's policy regarding estimated billing⁸ so that customers understand that it is the Company's policy to read residential meters monthly and estimate bills in those months when actual readings are not made. The clarified language reads as follows:

When meters are read on other than a monthly schedule, the Company may render estimated monthly bills to Customers for the periods when meter readings

⁸ Estimated billing is also discussed in the context of customer service improvements in Section VII, *infra*, of this Statement in Support.

are not obtained, and such bills shall be due and payable by each Customer upon presentation by the Company, subject to the Company's standard payment terms.

Tariff at Original Page 40. These clarifications provide residential customers with clear information that permit them to understand the Company's meter reading and estimated billing policies.

In Rule 11, Payment of Bills, language was removed from Rule 11.b, regarding late payment charges, such that the Rule now tracks the language of 52 Pa. Code § 56.22(a). See Tariff at Original Page 47. Additionally, the Company inserted language previously found only in West Penn Power's Tariff that permits the Company to reduce or eliminate interest on late payment charges to facilitate payment of bills under dispute. That language reads as follows:

At the Company's option, the interest per month associated with the late payment charge for Residential Customers may be reduced or eliminated in order to facilitate payment of bills under dispute.

Tariff at Original Page 46. This addition provides the Company with the flexibility to reduce or eliminate a portion of the customer's bill to facilitate customer payments. This is beneficial to customers because it may make their monthly bill more manageable and able to be paid.

In Rule 12, Administrative Charges, proposed language was not included as to repeated cancellation of electronic payments because it was overly broad. See Tariff at Original Page 47-48. The removal of this proposed paragraph was appropriate to protect both the Company and the Company's customers from misapplication.

The Settlement also contains a provision that recognizes that the Settlement terms do not encompass all of the changes made to Chapter of 14 of the Public Utility Code, 66 Pa. C.S. § 1401, *et. seq.*, by Act 155 of 2014 because the Commission has not provided guidance on how to incorporate Act 155 into tariffs as of the date that this Settlement was negotiated. Settlement ¶ 11(F)(4). The Settlement further states as follows:

Nothing contained herein shall preclude the Company from proposing further tariff changes at a later date based on Commission directives or guidance relating to implementing the provisions of Act 155 of 2014, or as otherwise necessary to implement the changes contained in Act 155 of 2014.

Settlement ¶ 11(F)(4). This provision is included to clarify that some changes were made with Act 155 in mind, but does not necessarily represent the entirety of changes related to Act 155 based on the Commission's future guidance on this issue, should any be issued.

The OCA submits that the modifications to Penn Power's Tariff will aid customers in understanding the Company's Rules and policies, while lessening potential confusion. The Tariff modifications will also allow customers to be more informed about their rights and is therefore in the public interest.

VII. CUSTOMER SERVICE AND RELIABILITY (Settlement ¶ 11(D))

OCA witness Alexander testified as to the Company's reliability of service and customer service (including performance of the call center, billing and estimated billing policies, complaint handling, and other metrics tracked by the Commission). See OCA St. No. 5 at 5-65. Ms. Alexander testified that Penn Power's customer service performance was lacking, particularly in the areas of bi-monthly meter reading and reliance on estimated meter readings that did not always appear to be in compliance with Chapter 56. OCA St. No. 5 at 24, 28-29, 30-33. Additionally, Ms. Alexander noted that Penn Power failed to achieve various customer service benchmarks and standards in 2013. OCA St. No. 5 at 18. Ms. Alexander's testimony also provided recommendations for improving reliability and customer service. See OCA St. No. 5 at 5-8, 31-33.

The Settlement provides for a number of customer service, estimated billing, and reliability provisions designed to ensure that the Company's customers receive adequate and reliable service and customer service performance at reasonable levels.

A. Customer Service and Estimated Billing

The Settlement provides that, relating to customer service, the Company will improve, then maintain a call answering rate of at least 80% within thirty seconds beginning with the twelve-month period ending December 31, 2016. Settlement ¶ 11(D)(1). Additionally, the Company will reduce the number of residential customer disputes not receiving a response within thirty days to no more than sixty beginning with the twelve-month period ending December 31, 2016. Settlement ¶ 11(D)(2).

Furthermore, the Settlement includes a number of provisions designed to address the issues related to estimated billing, based in part on Ms. Alexander's testimony and the public input testimony on this issue. See Public Input Hearing Transcript at 168-183 (Erie, PA on Nov. 10, 2014). First, the Company committed to continue reading residential meters on a monthly basis. Settlement ¶ 11(D)(5). Second, the Company will document the specific basis for failing to read residential meters monthly, if such a situation arises, and will categorize the reasons for non-reading. The Company will submit this documentation in an annual report to the statutory advocates. Settlement ¶ 11(D)(6). Third, the Company will revise its website and consumer education materials to explain that the Company's standard practice is to issue bills on actual meter reads monthly and the procedure for self-reading in the event an actual read is not taken by the Company. Settlement ¶ 11(D)(7). Fourth, the Company will provide its estimated billing algorithm to the OCA and other statutory advocates and will provide Company personnel to answer questions about the algorithm. The Company will also audit the accuracy and performance of the algorithm and provide a report and proposed modifications (if necessary) after the first year of use. Settlement ¶ 11(D)(8).

These Settlement provisions provide the Company's customers with clear information about how the Company bills its residential customers. Additionally, the terms put in place mechanisms for the parties to review the performance of the Company's meter reading and estimated billing policies to better ensure compliance with Chapter 56 and the issuance of reasonable bills to customers. As such, the OCA submits that these provisions are in the public interest.

B. Reliability

The Settlement also provides that the Company will consistently meet the Commission's System Average Interruption Duration Index (SAIDI, a measurement of the average length of interruptions), System Average Interruption Frequency Index (SAIFI, a measurement of the average frequency of interruptions), and Customer Average Interruption Frequency Index (CAIDI, a measurement of the average length of interruption by customers) for both twelve-month and three-year performance standards⁹ and strive to achieve reliability performance at or better than the Commission's performance benchmarks. Settlement ¶ 11(D)(3). The Settlement also provides that the Company will provide a report to the OCA and other interested parties in the event that the Company does not meet any of the performance standards and the corrective actions the Company plans to take to rectify the failure. Settlement ¶ 11(D)(4). Finally, the Settlement includes a term that precludes the Company from requesting any return on equity premium based on estimated meter reading, customer service, or reliability performance in its next base rate proceeding if the Company fails to consistently meet the requirements of this

⁹ These three measurements are defined by the Commission in its regulations, 52 Pa. Code Section 57.191-197, and are used to measure all Pennsylvania electric distribution companies' performance for non-major storm outages or interruptions. Therefore, these measurements exclude the outages associated with "major events" and are designed to reflect the "normal" operation of the distribution system under routine weather conditions and events.

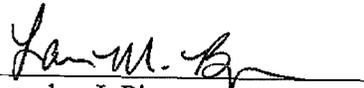
Settlement with regard to the customer service, reliability, or estimated billing terms. Settlement
¶ 11(F)(3).

The OCA submits that the reliability provisions provide affirmative benefits and are in the public interest. These initiatives could add to and enhance the commitments that were the focus of the OCA's concerns. The reliability benefits in the Settlement are designed to help the Company achieve and maintain an adequate and reliable level of service and are therefore in the public interest.

VIII. CONCLUSION

The OCA submits that the terms and conditions of the proposed Settlement of this rate investigation, taken as a whole, represent a fair and reasonable resolution of the issues raised by the OCA in this matter. Therefore, the OCA submits that the Settlement should be approved by the Commission without modification as being in the public interest.

Respectfully Submitted,



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February 3, 2015
00201351

Statement C

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	DOCKET NOS. R- 2014-2428744
	:	M-2013-2341993
	:	
PENNSYLVANIA POWER COMPANY	:	

**STATEMENT OF THE OFFICE OF SMALL BUSINESS ADVOCATE
IN SUPPORT OF THE JOINT PETITION FOR PARTIAL SETTLEMENT**

I. INTRODUCTION

The Small Business Advocate is authorized and directed to represent the interests of small business consumers in proceedings before the Pennsylvania Public Utility Commission (“Commission”) under the provisions of the Small Business Advocate Act, Act 181 of 1988, 73 P.S. §§ 399.41 - 399.50. In order to discharge this statutory duty, the Office of Small Business Advocate (“OSBA”) is participating as a party to this proceeding to ensure that the interests of small commercial and industrial (“Small C&I”) customers of Pennsylvania Power Company (“Penn Power” or the “Company”) are adequately represented and protected.

II. PROCEDURAL BACKGROUND

1. On August 4, 2014, Penn Power filed with the Commission Tariff Electric – Pa. P.U.C. No. 36 (“Tariff No. 36”) requesting an increase in annual distribution revenues of \$28.5 million. The proposed increase consisted of an increase in base rate operating revenues of

\$29.557 million, including the roll-in to base rates of the smart meter revenue requirement that was being recovered under the Smart Meter Technologies Charge (“SMT-C”) in effect on August 4, 2014, and proposed decreases in the Default Service Support and Hourly Pricing Default Service Riders totaling \$1.074 million (see Penn Power Statement No. 1, p. 8). On the same date, requests for an increase in distribution rates were filed by Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”), and West Penn Power Company (“West Penn”). On October 2, 2014, the Commission adopted an Order (the “Suspension Order”) suspending each of the tariff filings and referring the same to the Office of Administrative Law Judge for investigation to determine the lawfulness, justness, and reasonableness of the rates, rules, and regulations proposed by Met-Ed, Penelec, Penn Power and West Penn. Accordingly, Penn Power’s Tariff No. 36 was suspended by operation of law until May 3, 2015.

2. In an earlier proceeding related to the Company’s Smart Meter Deployment Plan, the Commission directed Penn Power to provide information on cost savings measures achieved from the deployment of smart meters and an explanation of how cost savings will be calculated in future SMT-C rate filings. See Docket No. M-2013-2341993. The Company requested that cost savings measures be addressed in the Company’s rate proceeding, instead of its August 1, 2014, annual SMT-C filing. Accordingly, as part of its August 4, 2014 base rate filing, Penn Power proposed a baseline for purposes of measuring savings achieved from the deployment of smart meters as well as the means for determining how cost savings resulting from smart meter deployment will be identified and flowed through to customers. In the Suspension Order (p.5),

the Commission found that the smart meter cost savings issue should be considered in Penn Power's base rate proceeding.

3. Notices of Appearance were served on behalf of the OSBA, the Commission's Bureau of Investigation and Enforcement ("I&E"), the Office of Consumer Advocate ("OCA"), and the Penn Power User's Group ("PPUG"). The OSBA and OCA also filed Complaints, as did PICA, and the Pennsylvania State University ("PSU"). Several Complaints were also filed by individual residential customers. Petitions to Intervene were filed by Noble Americas Energy Solutions, LLC ("Noble Americas"), the Environmental Defense Fund ("EDF") and Citizens for Pennsylvania's Future ("PennFuture"), CAUSE-PA, and Walmart, Inc.

4. A prehearing conference was held on October 8, 2014, at which a schedule was established for the submission of testimony and the conduct of evidentiary and public input hearings. To effectuate this schedule, Penn Power agreed to request an extension of the suspension period until May 19, 2015. This agreement provided that at the time any compliance filings are made, the Company may recoup through a surcharge revenues lost at the approved rates for the period from the statutorily prescribed end of suspension (i.e., May 3, 2015) through the date the Commission makes those rates effective by approving the compliance filing. All parties agreed to the terms of the conditional extension of the suspension period, and it was approved by the ALJs. A suspension tariff supplement reflecting the terms of the conditional extension of the suspension period was filed on October 29, 2014. In subsequent Orders, the ALJs found that the rate case dockets for Met-Ed, Penelec, Penn Power and West Penn would not be consolidated and further scheduled an evidentiary hearing for Penn Power on January 13, 2015, to address the base rate filing as well as smart meter cost savings issues.

5. Twelve public input hearings were held, which included locations within Penn Power's service territory as well as the service territories of the other three FirstEnergy companies:

6. Accompanying Tariff No. 36, Penn Power presented complete and separate data for the historic test year ended March 31, 2014, the future test year ending March 31, 2015, and the fully projected future test year ending April 30, 2016. The Company's supporting information included the prepared direct testimony of initial witnesses and the various exhibits sponsored by them. Considerable additional information was supplied by both Penn Power and the Complainant/Intervenor parties in response to interrogatories and data requests.

7. In accordance with the previously established schedule, on November 24, 2014, Complainant/Intervenor direct testimony and accompanying exhibits were served by I&E, OCA, OSBA, PPUG, EDF/PennFuture and Walmart. On December 18, 2014, rebuttal testimony and accompanying exhibits were served by Penn Power, OCA, and OSBA. On December 26, 2014, Penelec submitted two statements of supplemental testimony addressing issues identified in the ALJs' December 5, 2014 Prehearing Order. Finally, on January 6, 2015, surrebuttal testimony and accompanying exhibits were served by Penn Power, I&E, OCA, OSBA, EDF/PennFuture and Walmart.

8. Negotiations were conducted by the Joint Petitioners in an effort to achieve a settlement of the issues in this case. As a result of those negotiations, the Joint Petitioners were able to agree to the Settlement set forth herein which resolves all issues among the Joint Petitioners. However, the Settlement does not resolve the issue raised by PennFuture concerning

the scope and pricing of Penn Power's LED street lighting offering. This issue is reserved for briefing. In light of the Settlement and the fact that all parties to this proceeding waived cross-examination, a hearing was held on January 14, 2015 solely for the purpose of entering testimony and exhibits into the record.

III. STATEMENT IN SUPPORT

B. OSBA's Position

9. On October 6, 2014, the OSBA filed its Prehearing Memorandum in this proceeding. In the Prehearing Memorandum, the OSBA identified the following specific issues of concern:

1. Small C&I rates.
2. Cost of service and cost allocation.
3. Revenue allocation.
4. Rate design.

C. Small C&I Rates, Cost of Service/Cost Allocation

10. The OSBA deemed that small business customers were generally represented in the GSS and GSM rate classes.

11. The OSBA was concerned that the originally filed cost allocation study contained certain modest methodological errors, but that, to the extent these errors could be corrected, the overall results of Penn Power's filed cost allocation study changed only modestly.

D. Revenue Allocation

12. Regarding revenue allocation to small business customers, the OSBA concluded that the Company's revenue allocation proposal was not consistent with either its own cost allocation study or the OSBA's cost allocation study. Consistent with OSBA's principled position regarding aligning rates with costs, and in light of the *Lloyd* decision, the OSBA recommended that the increase for the Rate GSS class be somewhat higher than that proposed by the Company, and the increase for Rate GSM be somewhat lower than that proposed by the company. Relative to a scaleback of Penn Power's filed position, the settlement follows these recommendations. For the two combined classes, the revenue allocation in the settlement is approximately equal to a scaleback of the Company's filed position, but it assigns more revenues to GSS and lower revenues to GSM, consistent with the results of the cost allocation study. The OSBA notes further that the settlement revenue requirements for both Rate GSS and Rate GSM lie within the range of litigation positions of the various parties (appropriately scaled back). Thus, the OSBA concludes that small business customers are treated fairly in the settlement.

E. Rate Design

12. With respect to rate design for the Rate GSS class, the OSBA generally agreed with Penn Power's proposed approach of adopting a customer charge and flat energy charge, suggesting that changes to the company's filed position increase the emphasis on the energy charge. This proposal is reflected in the settlement rate design, in that the increase to Rate GSS is applied entirely to the energy charge relative to the filed position.

13. Regarding rate design for the Rate GSM class, the OSBA generally agreed with the company's proposed approach of adopting a customer charge/demand charge tariff structure, and had no specific concerns with the relative magnitude of the charges. The tariff structure as filed is retained in the settlement. The settlement applies the scaleback primarily to the demand charge, which the OSBA deems to be reasonable as the proposed customer charge as filed for Rate GSM was actually slightly below the customer charge for Rate GSS.

IV. CONCLUSION

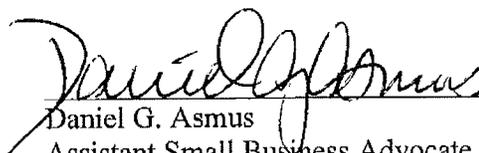
14. The partial settlement of this proceeding avoids the litigation of many of the complex, competing proposals and saves the possibly significant costs of further and more extended administrative proceedings. Such costs are borne not only by the Joint Petitioners, but ultimately by the Company's customers as well. Avoiding extended litigation of this matter has served judicial efficiency, and allows the OSBA to more efficiently employ its resources in other areas.

15. The OSBA acknowledges that, except to the extent specifically set forth herein, the Joint Petitioners have not sought, nor would they be able, to agree upon the specific rate case adjustments which support their respective conclusions. Nonetheless, the OSBA is in full agreement that this Settlement is in the best interest of customers and the Company and, therefore, is in the public interest.

16. For the reasons set forth in the Joint Petition, as well as the additional factors enumerated in this statement, the OSBA supports the proposed Joint Petition and respectfully

requests that ALJs Buckley and Dunderdale and the Commission approve the Joint Petition in its entirety without modification.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Daniel G. Asmus", is written over a horizontal line.

Daniel G. Asmus
Assistant Small Business Advocate
Attorney ID No. 83789

For:

John R. Evans
Small Business Advocate

Office of Small Business Advocate
300 North Second Street, Suite 202
Harrisburg, PA 17101

Dated: February 3, 2015

Statement D

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2014-2428744
	:	M-2013-2341993
Pennsylvania Power Company	:	

**BUREAU OF INVESTIGATION AND ENFORCEMENT
STATEMENT IN SUPPORT OF
JOINT PETITION FOR SETTLEMENT**

**TO ADMINISTRATIVE LAW JUDGES DENNIS BUCKLEY AND KATRINA
DUNDERDALE:**

The Bureau of Investigation and Enforcement (I&E) of the Pennsylvania Public Utility Commission (Commission), by and through its Prosecutors Allison C. Kaster, Carrie B. Wright and Scott B. Granger, hereby respectfully submits that the terms and conditions of the foregoing Joint Settlement Petition (Joint Petition or Settlement) are in the public interest and represent a fair, just, and reasonable balance of the interests of Pennsylvania Power Company (Penn Power or Company) and its customers:

I. BACKGROUND

1. I&E is charged with representing the public interest in Commission proceedings related to rates, rate-related services, and applications affecting the public interest. In negotiated settlements, it is incumbent upon I&E to identify how amicable resolution of any such proceeding benefits the public interest and to ensure that the public

interest is served. Based upon I&E's analysis of Penn Power's base rate filing, acceptance of this proposed Settlement is in the public interest and I&E recommends that the Administrative Law Judges and the Commission approve the Settlement in its entirety.

2. On August 4, 2014, Penn Power filed Tariff Electric-PA. P.U.C. No. 36 to become effective October 3, 2014, calculated to produce approximately \$28,483,000 in additional annual revenues, or 8.7% over present revenues. By Order entered October 2, 2014 the Commission instituted a formal investigation to determine the lawfulness, justness, and reasonableness of Penn Power's existing and proposed rates, rules, and regulations. The effective date of Tariff Electric-PA. P.U.C. No. 36 was suspended by operation of law until May 3, 2015, unless permitted by Commission Order to become effective at an earlier date.

3. In an earlier proceeding related to the Company's Smart Meter Deployment Plan, the Commission directed Penn Power to provide information on cost savings measures achieved from the deployment of smart meters and an explanation of how cost savings will be calculated in future Smart Meter Technologies Charge ("SMT-C") rate filings.¹ The Company requested that cost savings measures be addressed in the instant base rate proceeding, instead of its annual SMT-C filing. Accordingly, as part of its August 4, 2014 base rate filing, Penn Power proposed a baseline for purposes of measuring savings achieved from the deployment of smart meters as well as the means

¹ Docket No. M-2013-2341991.

for determining how cost savings resulting from smart meter deployment will be identified and flowed through to customers.

4. In the Suspension Order, the Commission found that the smart meter cost savings issue should be considered in Penn Power's base rate proceeding.

5. Administrative Law Judges Dennis Buckley and Katrina Dunderdale (ALJs) were assigned to this proceeding for purposes of conducting hearings and issuing a Recommended Decision.

6. I&E entered the Notice of Appearance of Prosecutors Allison C. Kaster, Carrie B. Wright, and Scott B. Granger in this proceeding on September 9, 2014.

7. The ALJs held a prehearing conference on October 8, 2014, during which the parties agreed to a schedule for the conduct of the case including the service of testimony among the parties and the dates for evidentiary hearings.

8. All statutory parties undertook comprehensive discovery in this proceeding.

9. In accordance with the procedural schedule established at the prehearing conference, I&E served all active parties the following pieces of testimony and accompanying exhibits in the base rate proceeding at Docket No. R-2014-2428744:

I&E Statement No. 1 and I&E Exhibit No. 1: Direct Testimony and Exhibit of Rachel Maurer;

I&E Statement No. 1-SR and I&E Exhibit No. 1-SR: Surrebuttal Testimony and Exhibit of Rachel Maurer;

I&E Statement No. 2 and I&E Exhibit No. 2 (Proprietary and Public versions): Direct Testimony and Exhibit of Christine Wilson;

I&E Statement No. 2-SR and I&E Exhibit No. 2-SR: Surrebuttal Testimony and Exhibit of Christine Wilson;

I&E Statement No. 3 and I&E Exhibit No. 3: Direct Testimony and Exhibit of Jeremy Hubert;

I&E Statement No. 3-SR: Surrebuttal Testimony of Jeremy Hubert;

I&E Statement No. 4 and I&E Exhibit No. 4: Direct Testimony and Exhibit of Kokou Apetoh;

I&E Statement No. 4-SR and I&E Exhibit No. 4-SR: Surrebuttal Testimony and Exhibit of Kokou Apetoh;

I&E Statement No. 5 and I&E Exhibit No. 5: Direct Testimony and Exhibit of Lisa Boyd; and,

I&E Statement No. 5-SR: Surrebuttal Testimony of Lisa Boyd.

10. Additionally, I&E served all active parties the following pieces of testimony and accompanying exhibits in the smart meter proceeding at Docket No. M-2013-2341993:

I&E Statement No. 1: Direct Testimony and Exhibit of Jeremy Hubert; and

I&E Statement No. 3-SR: Surrebuttal Testimony of Jeremy Hubert.

11. In accordance with Commission policy favoring settlements at 52 Pa. Code § 5.231, I&E participated in multiple in-person and telephonic settlement discussions with the Company and other parties to the proceeding. Following extensive settlement negotiations, the parties reached a settlement of all issues with the exception of an issue involving PennFuture.

II. TERMS AND CONDITIONS OF SETTLEMENT

12. It is the policy of the Commission to encourage settlements.² The Commission issued the following policy statement that articulates general settlement guidelines and procedures for major rate cases:

In the Commission's judgment, the results achieved from a negotiated settlement or stipulation, or both, in which the interested parties have had an opportunity to participate are often preferable to those achieved at the conclusion of a fully litigated proceeding. It is also the Commission's judgment that the public interest will benefit by the adoption of §§ 69.402—69.406 and this section which establish guidelines and procedures designed to encourage full and partial settlements as well as stipulations in major section 1308(d) general rate increase cases.³

13. This policy statement highlights the importance of settlement in Commission proceedings. The instant rate case was filed on August 4, 2014, and over the past five months, the parties engaged in extensive formal and informal discovery, preparation of testimony, and lengthy settlement discussions. All signatories to the Joint Petition actively participated in and vigorously represented their respective positions during the course of the settlement process. As such, the issues raised by I&E have been satisfactorily resolved through discovery and discussions with the parties and are incorporated in the Joint Petition. I&E represents that the Settlement satisfies all applicable legal standards and results in terms that are preferable to those that may have been achieved at the end of a fully litigated proceeding. Accordingly, for the reasons articulated below, I&E maintains that the proposed Settlement is in the public interest and

² 52 Pa. Code § 5.231.

³ 52 Pa. Code § 69.401.

requests that the following terms be approved by the ALJs and the Commission without modification:

A. Revenue Requirement

1. Rate Increase (Joint Petition ¶ 11.A.1)

As proposed, Penn Power requested a revenue increase of \$28,483,000.

I&E analyzed the ratemaking claims contained in the Company's filing including, but not limited to, operating and maintenance expenses, taxes, rate base, and the cost of common equity. In its direct case, I&E recommended a revenue increase of \$12,865,000.

In the Settlement, Joint Petitioners agree to an increase in base rates to allow the Company the opportunity to recover an increase of \$17,000,000, which includes distribution revenue, smart meters and storm reserves, in lieu of the \$28,483,000 originally requested, which represents a \$11,483,000 savings for customers.

I&E analyzed the ratemaking claims contained in the Company's filing including operating and maintenance expenses, taxes, cash working capital, rate base, rate structure, capital structure, and the cost of common equity and long-term debt. After this review and engaging in extensive discovery and settlement discussions, I&E fully supports the revenue level compromised upon in the Settlement. Due to the "black box" nature of the Settlement, the Settlement does not reflect agreement upon individual issues; rather, the parties have agreed to an overall increase to base rates that is substantially less than what was requested by the Company. Line-by-line identification and ultimate resolution of every issue raised in the proceeding is not necessary to find that the Settlement is in the

public interest nor could such a result be achieved as part of a settlement. Black box settlements benefit ratepayers because they allow for the resolution of a contested proceeding at a level of increase that is below the amount requested by the regulated entity and in a manner that avoids the significant expenditure of time and resources related to further litigation.

Black box settlements are not uncommon in Commission practice. Indeed, the Commission has endorsed the use of black box settlements, as discussed in a recent Order approving such a settlement:

We have historically permitted the use of “black box” settlements as a means of promoting settlement among the parties in contentious base rate proceedings. *See, Pa. PUC v. Wellsboro Electric Co.*, Docket No. R-2010-2172662 (Final Order entered January 13, 2011); *Pa. PUC v. Citizens’ Electric Co. of Lewisburg, PA*, Docket No. R-2010-2172665 (Final Order entered January 13, 2011). Settlement of rate cases saves a significant amount of time and expense for customers, companies, and the Commission and often results in alternatives that may not have been realized during the litigation process. Determining a company’s revenue requirement is a calculation involving many complex and interrelated adjustments that affect expenses, depreciation, rate base, taxes and the company’s cost of capital. Reaching an agreement between various parties on each component of a rate increase can be difficult and impractical in many cases. For these reasons, we support the use of a “black box” settlement in this proceeding and, accordingly, deny this Exception.⁴

⁴ *Pa. PUC v. Peoples TWP LLC*, Docket No. R-2013-2355886, p. 28 (Order entered December 19, 2013).

I&E individually, and the Joint Petitioners collectively, considered, discussed, and negotiated all issues of import in this Settlement. From a holistic perspective, each party has agreed that the Settlement benefits its particular interest. The Commission has recognized that a settlement “reflects a compromise of the positions held by the parties of interest, which, arguably fosters and promotes the public interest.”⁵ The Settlement in this proceeding promotes the public interest because a review of the testimony submitted by all parties demonstrates that the Joint Petition reflects a compromise of the litigated positions held by those parties. Therefore, I&E submits that the Settlement balances the interests of Penn Power and its customers in a fair and equitable manner and presents a resolution for the Commission’s adoption that best serves the public interest.

Public utility regulation allows for the recovery of prudently incurred expenses as well as the opportunity to earn a reasonable return on the value of assets used and useful in public service. The increase proposed in this Settlement respects this principle. Ratepayers will continue to receive safe and reliable service at just and reasonable rates while allowing the Company sufficient additional revenues to meet its operating and capital expenses and providing the opportunity to earn a reasonable return on its investment. As discussed above, the Settlement rates significantly moderate the increase initially proposed by the Company and, I&E believes, properly balances the interests of all parties. Accordingly, I&E submits that the proposed Settlement is in the public

⁵ *Pa. PUC v. C S Water and Sewer Associates*, 74 Pa. PUC 767, 771 (1991).

interest and requests that it be approved by the ALJs and the Commission without modification.

2. Overall Rate of Return and Return on Equity

By Order dated December 5, 2014, the ALJs directed that “Any settlement agreement filed by the parties must specify the Rate of Return and the Return on Equity though not the methodology used to arrive.”⁶ The Order recognized that settlements are traditionally black box in nature as they are silent about the specific items that comprise the revenue requirement; however, it nevertheless states that it is “expected that financial data submitted in support of any filed tariff Supplements will support the results of settlement petition(s).”⁷ As indicated by ALJ Dunderdale, providing this detailed information would mean that this settlement is not a black box settlement:

[T]here is an issue...with Rate of Return and the Return on Equity. These two elements, if the parties are ever successful in reaching a settlement, --that--if the settlement is a black box these two elements should be outside of that box.⁸

The ALJs’ concern about obtaining this information appears to stem from an issue raised at the Uniontown public input hearing. At a further prehearing conference held on November 25, 2014, ALJ Dunderdale indicated that capital structure may be a concern because a FirstEnergy employee testified at the Uniontown hearing that “they were told to replace light bulbs that needed replaced with the entire head so that the cost would be applied towards capital. So it is a possibility that capital structure may become an

⁶ Order, p. 7 (December 5, 2014).

⁷ Order, p. 7 (December 5, 2014).

⁸ Further Prehearing Conference Tr. at 571 (November 25, 2014).

issue.”⁹ It is important to note that no witness in Penn Power’s service territory testified that the Company was purposely increasing capital expenditures. The streetlight issue that the ALJs expressed concerned about at the November 25, 2014 prehearing conference was raised by a West Penn employee at the Uniontown public input hearing, and no similar allegation was raised in the Met-Ed, Penelec or Penn Power service territories. Because of this West Penn employee’s testimony, the ALJs have directed the parties to present the overall rate of return and ROE in the four FirstEnergy Settlements.

However, ALJ Dunderdale recognized that whether capital structure is an issue depends “on how FirstEnergy responds to some of the allegations that came out of the public input.”¹⁰ The Company has fully addressed the concerns raised at the public input hearing; therefore, identifying an overall rate of return and specific return on equity (ROE) in the Settlement is unnecessary. West Penn witness Strah’s testimony explains why, in some circumstances, it is appropriate to replace the whole head of a streetlight if a bulb fails.¹¹ West Penn witness Strah explained that mercury vapor bulbs are no longer available in the United States; therefore, if one of those bulbs fails, the Company’s only option is to replace it with a high pressure sodium streetlight that requires a new head.¹² Other appropriate reasons to replace the streetlight head include whether the bulb needs to be changed more frequently than normal, when the light will not work despite a bulb

⁹ Further Prehearing Conference Tr. at 572 (November 25, 2014).

¹⁰ Further Prehearing Conference Tr. at 572 (November 25, 2014).

¹¹ West Penn Statement No. 11-S, pp. 7-8.

¹² West Penn Statement No. 11-S, p. 8.

replacement or if there is a change in size or location made by a municipality.¹³ In general, the Company explained that it applies several criteria when determining whether to make a repair or a capital replacement:

Whether to replace property constituting one or more retirement units or to make a non-capital repair is based on a number of factors including, among others, infrastructure needs, regulatory requirements, historic failure rates, and related cost-efficiency factors. Applying those criteria, there are many instances where it is more cost effective to replace units of property than try to repair existing property.¹⁴

These types of operational decisions are generally left to the discretion of the Company and I&E has not made any alternative recommendations in this proceeding. It is well settled that the Commission may not interfere with or micromanage utility management decisions unless there is a manifest abuse of discretion or some showing of arbitrary utility action.¹⁵ The Company's testimony demonstrates that no such abuse or arbitrary action has occurred.

Additionally, it appears that the ALJs believe that articulating a specific ROE in the Settlement is necessary because there is some concern that the return on equity is identical for the four Companies. At the November 25, 2014 prehearing conference, ALJ Dunderdale stated:

It seems that the return on equity may be identical for all four companies. That's really kind of hard to do without something unusual going on with the numbers.¹⁶

¹³ West Penn Statement No. 11-S, p. 8.

¹⁴ West Penn Statement No. 11-S, p. 7.

¹⁵ *Pa. P.U.C. v. Philadelphia Electric Co.*, 522 Pa. 338 (1989).

¹⁶ Further Prehearing Conference Tr. at 573 (November 25, 2014).

And:

If it's true that the rate of return is identical across all four companies that really brings into question whether or not the return on equity is in the public interest.¹⁷

It is appropriate and in the public interest to utilize the same cost of common equity for the four Companies. Although I&E's overall rate of return recommendation for the four Companies differed due to different capital structures and debt cost rates, I&E recommended the same 8.84% cost of common equity for all four Companies.¹⁸ The determination of an appropriate return on common equity in this proceeding entailed a market-based recommendation predicated upon a group of companies with publicly traded common stock and investment risk similar to the Company. To arrive at an appropriate recommended return on common equity, I&E witness Maurer employed the Discounted Cash Flow (DCF) method applied to a barometer group of similar utilities and used the Capital Asset Pricing Model (CAPM) as a comparison to the DCF results. Given that the identical analysis was performed for the four FirstEnergy Companies, I&E recommended the identical ROE for those Companies. I&E's determination of the appropriate ROE was discussed at length in its rate of return testimony, which demonstrates that there is nothing unusual with recommending the same ROE for utilities in the same industry with similar risk. Likewise, the Company and OCA performed their own analysis, which resulted in 10.90% and 9.27% recommendations for all four Companies, respectively. Therefore, the fact that the litigation and potential settlement

¹⁷ Further Prehearing Conference Tr. at 573 (November 25, 2014).

¹⁸ I&E's overall rate of return recommendation was 7.03% for Met-Ed, 7.28% for Penelec, 7.48% for Penn Power and 7.11% for West Penn.

positions of the parties utilize the identical ROE for the four Companies does not mean that those recommendations are contrary to the public interest and does not necessitate identifying a specific ROE in the Settlement.

The concern raised at the Uniontown public input hearing cannot undermine the black box nature of Commission settlements. As discussed at length above, the Commission has supported the use of black box settlements because determining a revenue requirement involves complex and interrelated adjustments (expenses, depreciation, rate base, taxes, cost of capital) and reaching an agreement between all of the parties on these components could be difficult and impractical. As such, there is no one, uniform way that the parties reached the agreed upon \$17,000,000 revenue requirement. I&E may have been able to agree to the recommended \$17,000,000 by keeping its ROE relatively low but removing or reducing some of its recommended expense adjustments, while another party may have gotten to that number by imputing more expense adjustments but allowing for a higher equity return. In short, there are a myriad of ways that different parties can reach the agreed upon revenue requirement, which means that there is no one ROE or overall rate of return that the parties can specify in the Settlement.

Additionally, the Commission has rejected attempts to remove the ROE from the black box settlement. In Aqua's 2012 base rate proceeding, the parties entered into a black box settlement that was silent on the ROE, capital structure and other components

that comprised the agreed upon revenue requirement.¹⁹ Despite the fact that the settlement was silent on these inputs, the ALJs attempted to calculate the ROE. Parties filed Exceptions to the ALJs' ROE calculation contending that a black box settlement does not include details of how specific ratemaking issues were resolved. The Commission agreed and ordered that the ALJs' ROE calculation be ignored because it must determine whether the overall revenue increase is in the public interest, not whether the specific components that comprise the revenue requirement is in the public interest:

In considering the Settlement, we are determining, *inter alia*, whether an increase of \$16.7 million in annual operating revenue is in the public interest without making a determination of any specific components that may have led to the calculation of the specific revenue requirement. Consequently, we are unable to make any determination regarding the rate of ROE that Aqua may ultimately realize from the rates adopted under the proposed Settlement. Accordingly, the ALJs' Attachment 1 may not be used as a benchmark or for comparison purposes to the agreed-upon DSIC ROE, within the context of this proceeding. Additionally, any reference to the ALJs' ROE calculation should be ignored.²⁰

Similarly, the Commission must determine whether the proposed Penn Power revenue increase of \$17,000,000 contained in the Settlement, in lieu of the \$28,483,000 requested in the Company's filing, is in the public interest. For the reasons provided above, I&E submits that the proposed increase negotiated by the parties is in the public interest and that the Commission can make this determination despite the fact that the return on equity and overall rate of return is not explicitly provided in the Settlement.

¹⁹ *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, R-2011-2267958 (Order entered June 7, 2012).

²⁰ *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, R-2011-2267958, p. 27 (Order entered June 7, 2012).

3. Roll Smart Meter Costs into Distribution Rates (Joint Petition ¶ 11.A.2)

Penn Power currently has a Smart Meter Technologies Charge (“SMT-C”) Rider that sets forth a Commission-approved adjustment clause imposing a SMT-C to recover the costs of implementing their Smart Meter Deployment Plan (“Smart Meter Plan”).²¹ The development of Smart Meter Deployment Plans was just one of the requirements of Act 129.²² Act 129 provides that an EDC is entitled to full and current recovery of the costs associated with implementing a smart meter system, net of any operational and capital benefits the system will create. Act 129 also allows an EDC to recover its net costs either on a current basis through a Section 1307 reconcilable surcharge or in base rates with authority to defer costs incurred between base rate proceedings (66 Pa. C.S. § 2807(f)(7)).²³ These provisions of Act 129 are fully discussed in the Implementation Order for Act 129 at Docket No. M-2008-2069887, entered on January 16, 2009.²⁴

Accordingly, Penn Power proposed to include in their distribution base rate revenue requirements their costs to implement their Smart Meter Plans; to recover those costs in their distribution base rates; and to reduce their SMT-C Rider rates to zero.²⁵ Penn Power also proposed that the SMT-C Rider remain in the Company’s tariff as the

²¹ Penn Power Statement No. 1 p. 6.

²² I&E St. No. 3, pp. 14-15 at Docket No. R-2014-2428744. *See also*, I&E St. No. 1, p. 2 at Docket No. M-2013-2341993.

²³ I&E St. No. 3, pp. 15-16 at Docket No. R-2014-2428744. *See also*, I&E St. No. 1, p. 3 at Docket No. M-2013-2341993.

²⁴ I&E St. No. 3, p. 16 at Docket No. R-2014-2428744. *See also*, I&E St. No. 1, p. 3 at Docket No. M-2013-2341993.

²⁵ Penn Power Statement No. 1 p. 6.

mechanism to recover costs of implementing their Smart Meter Plan, net of savings, in excess of such costs being recovered in base rates in the future.²⁶

The Joint Petition notes that in an earlier proceeding related to the Company's Smart Meter Deployment Plan, the Commission directed Penn Power to provide information on cost savings measures achieved from the deployment of smart meters and an explanation of how cost savings will be calculated in future SMT-C rate filings.²⁷ The Company requested that cost savings measures be addressed in the Company's rate proceeding, instead of its August 1, 2014, annual SMT-C filing. Accordingly, as part of its August 4, 2014 base rate filing, Penn Power proposed a baseline for purposes of measuring savings achieved from the deployment of smart meters as well as the means for determining how cost savings resulting from smart meter deployment will be identified and flowed through to customers.²⁸

I&E did not oppose the Company's request to roll smart meter costs into base rates; however, I&E wanted to ensure that the Company did not over-recover such costs through base rates and the SMT-C Rider.²⁹ Therefore, I&E asserted that the SMT-C Rider should allow full recovery of actual costs, no more and no less, ensuring that customers are paying only costs that the Company incurs.³⁰

²⁶ Penn Power Statement No. 1 pp. 6-7.

²⁷ Joint Petition, pp. 2-3. See Docket No. M-2013-2341993.

²⁸ Joint Petition, p. 3.

²⁹ I&E St. No. 3, p. 17 at Docket No. R-2014-2428744. *See also*, I&E St. No. 1, p. 5 at Docket No. M-2013-2341993.

³⁰ I&E St. No. 3, p. 17 at Docket No. R-2014-2428744. *See also*, I&E St. No. 1, p. 5 at Docket No. M-2013-2341993.

After a full analysis of the Company's representation of its smart meter costs and lengthy settlement negotiations, the Joint Petitioners have agreed that the Company's total revenue requirement includes \$12.483 million associated with smart meter deployment.³¹ Furthermore, once the aggregate investment and expense revenue requirements exceed \$12.483 million, the Company may begin deferring costs that are eligible for recovery under its SMT-C Rider (Rider G).³² When the \$12.483 million threshold revenue requirement is exceeded and the Company begins deferring costs in excess of that amount, the Company will file a smart meter rate under Rider G to recover all investment and expense revenue requirements in excess of the \$12.483 million included in base distribution rates.³³

I&E fully supports the settled upon smart meter cost recovery methodology as set forth in the Joint Petition. I&E believes that the settled upon smart meter cost recovery methodology is consistent with prior Commission decisions,³⁴ provides stability to Penn Power, and provides protection from volatility; all of which are consistent with protecting the public interest.

³¹ Joint Petition, p. 7.

³² Joint Petition, p. 7.

³³ Joint Petition, p. 7.

³⁴ I&E St. No. 3, pp. 15-16 at Docket No. R-2014-2428744. *See also*, I&E St. No. 1, p. 3 at Docket No. M-2013-2341993.

4. Amortization of Legacy Meters (Joint Petition ¶ 11.A.3)

The Joint Petitioners agree that the Company's unamortized investment associated with the legacy meters will be amortized over a five-year period, beginning on the date the Settlement Rates become effective.³⁵

I&E recognizes that based on the Commission-approved Smart Meter Deployment Plan³⁶ the Company anticipates they will be replacing 98.5% of all existing ("legacy") meters with smart meters by December 31, 2019.³⁷ I&E also recognizes that on June 24, 2009, the Commission entered an Order, detailing the standards and guidelines for implementing the smart meter requirements of Act 129 (Implementation Order at Docket No. M-2009-2092655) which states:

The Commission believes the EDCs should install smart meters in a manner that coincides with the full depreciation of existing meters, so as to minimize the stranded costs. However, in the event that there are stranded costs that need to be recovered the Commission agrees with EA, PECO and Duquesne that EDCs should be allowed to seek recovery of those costs through an accelerated depreciation schedule, to be included in the EDC's cost recovery plan.

(Implementation Order, p. 33).³⁸

As indicated in the Implementation Order, the Commission has recognized that an EDC could seek recovery of "stranded costs" through an accelerated depreciation schedule.³⁹

Therefore, in consideration of all of the above, I&E did not oppose and now supports the settled upon legacy meter amortization methodology as set forth in the Joint

³⁵ Joint Petition, p. 7.

³⁶ See, Docket No. M-2013-2341993.

³⁷ I&E St. No. 3, p. 18 at Docket No. R-2014-2428744.

³⁸ I&E St. No. 3, pp. 20-21 at Docket No. R-2014-2428744.

³⁹ I&E St. No. 3, p. 21 at Docket No. R-2014-2428744.

Petition. I&E believes that the settled upon legacy meter amortization methodology is consistent with prior Commission decisions,⁴⁰ provides stability to Penn Power, and provides protection from volatility; all of which are consistent with protecting the public interest.

5. Storm Reserve Account (Joint Petition ¶ 11.A.4)

In its filing, the Company proposed to recover \$657,000 of storm damage expense through base rates and that all storm costs in excess of this base rate amount be recovered through its proposed Storm Damage Charge Rider (Rider B). Rider B is a newly proposed 1307(e) rider designed to recover storm costs on an annual and fully reconcilable basis. In proposing Rider B, the Company relied on the Commission's recent approval of PPL's Storm Damage Expense Rider (SDER).⁴¹

I&E opposed the Company's Storm Damage Rider for three reasons. First, PPL's SDER has been appealed to the Commonwealth Court; therefore, given the uncertainty of the outcome of the ongoing appeal, I&E did not believe that it was currently prudent to engage in the costs of addressing the proposed Rider B.⁴² Second, the Company's proposed Rider B had several design features that were different from PPL's SDER.⁴³ The Company sought to recover all storm costs beyond the amount included in base rates, but placed no limit on the type of storm expenses to be reimbursed and made no distinction between ordinary storm occurrences and those that would be deemed

⁴⁰ I&E St. No. 3, p. 20-21 at Docket No. R-2014-2428744.

⁴¹ I&E St. No. 5, p. 22.

⁴² I&E St. No. 5, p. 22.

⁴³ I&E St. No. 5, p. 23.

reportable or extraordinary. Additionally, the Company's proposed rider placed no limit on annual recovery; therefore, assuming full recovery of all storm costs (normal to extraordinary) in a one year period could result in volatile rates. In contrast, PPL's approved SDER was designed with several limitations or caps to the annual recoverable amount in order to limit the potential volatility. Specifically, a limitation to cover only PUC reportable storms, an upper annual rider recovery limit not to exceed 3% of intrastate distribution revenues, an automatic three-year amortization of any annual storm deemed extraordinary, and the sum of amortized and annual storms not to exceed the 3% limit with any unrecovered amortized storms addressed at a subsequent base rate case.⁴⁴ Third, I&E's did not recommend a 1307(e) annually reconcilable rider in the PPL proceeding.⁴⁵ Instead, I&E recommended calculating an annual budget amount to reflect a five year average of storm expenses to account for yearly fluctuations in storm expenses, and to use that annual base rate budget amount to fund a reconcilable storm reserve account.⁴⁶

The Settlement provides that the Company will not establish Rider B as proposed, but instead will establish a Storm Reserve Account. The Company originally proposed the recovery of storm damage expenses through base rates in the amount of \$657,000, which I&E recognized would not provide adequate margin to establish a reserve account in a reasonable timeframe given that the Company's five year average of expenses is

⁴⁴ I&E St. No. 5-R, p. 24.

⁴⁵ I&E St. No. 5, pp. 23-24.

⁴⁶ I&E St. No. 5, p. 24.

\$945,927.⁴⁷ In the Settlement, the parties agree that the \$17,000,000 revenue requirement includes \$1,000,000 to be recovered for the purposes of funding the Storm Reserve Account. This \$1,000,000 represents a five-year average of storm damage expense, excluding expenses associated with extraordinary storms. The Company will continue to be able to account for extraordinary storm expense through the current practice of petitioning the Commission for approval to defer such expense.

The Storm Reserve Account proposed in the Settlement is in the public interest as it helps self-insure the Company for distribution system storm damage expenses. It protects ratepayers from the potential volatility of an annually variable rider as originally proposed by the Company. Additionally, the Storm Reserve Account is in the Company's interest because the reserve will be properly funded based on a five year average of experienced storms, which will potentially avoid an unfavorable impact on the Company's financial statement that could result from year-to-year fluctuations in actual storm costs. Accordingly, I&E maintains that the \$1,000,000 Storm Reserve Account should be approved in this proceeding without modification.

**6. Fully Projected Future Test Year Reporting Requirements
(Joint Petition ¶ 11.A.5)**

In this base rate filing, Penn Power elected to use a Fully Projected Future Test Year (FPFTY) consisting of the twelve months ended April 30, 2016 as permitted under Act 11 of 2012. The FPFTY is a dramatic change from the standard ratemaking process.

⁴⁷ I&E St. No. 5, p. 29.

Although previously allowing for use of a Future Test Year, Section 315 of the Public Utility Code, 66 Pa.C.S. § 315, traditionally required that utility investment be used and useful in the provision of service before the investment was reflected in rates. However, as amended under Act 11, Section 315 now allows a utility to project investment and include it in the claimed revenue requirement through the twelve-month period beginning with the first month that the new rates will be placed in effect. By allowing this extended projection, the FPFTY essentially allows a utility to require ratepayers to pay a return on its projected investment in future facilities that are not in place and providing service at the time the new rates take effect and that are not subject to any guarantee of being completed and placed into service.

While Section 315 of the Public Utility Code, 66 Pa.C.S. § 315, authorizes the use of such projections, I&E sought to have Penn Power provide interim reports until the Company's filing of its next base rate case in order to be able to timely review and verify the status of the Company's rate base projections. Specifically, in the Settlement, Penn Power agreed to provide to I&E, OCA, and OSBA updates to Penn Power Exhibit RAD-47 on or before August 1, 2015 for the twelve months ending March 31, 2015. Also on or before July 1, 2016 the Company will provide an update to Penn Power Exhibit RAD-46 to the statutory advocates for the twelve months ending April 30, 2016. In addition, Penn Power agreed to provide, as a part of the next base rate case, a comparison of its actual expenses and rate base additions for the twelve months ended April 30, 2016 to the projections in this case. Accordingly, I&E fully supports the Settlement because this

condition achieves I&E's goal of timely receiving data sufficient to allow for the evaluation and confirmation of the accuracy of Penn Power's projections in its next base rate filing.

7. DSIC and Smart Meter ROE (Joint Petition ¶ 11.A.6)

The parties agree that for the purpose of calculating a distribution system improvement charge (DSIC), if a DSIC is hereafter approved by the Commission, and calculating the incremental revenue requirement associated with smart meter deployment that is eligible for recovery through the SMT-C Rider, the Company shall use the return on equity calculated for electric utilities by the Commission's Bureau of Technical Utility Services (TUS) in its quarterly earnings report. With regard to the DSIC ROE, the Commission has interpreted Act 11 and the DSIC Implementation Order, to require rate case settlements to include a stipulated ROE for DSIC calculation purposes.⁴⁸ The Commission has articulated that this ROE stipulation can be accomplished in one of two ways:

The options to accomplish this include stipulating to a fixed ROE for DSIC calculation purposes or stipulating that the ROE for DSIC calculation purposes will track the equity return rate from the most recent staff Quarterly Report. In either case, a rate case settlement should include a clear statement of the equity return rate to be used for DSIC purposes.⁴⁹

⁴⁸ *Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, R-2014-2406274, p. 15 (Order entered December 10, 2014).

⁴⁹ *Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, R-2014-2406274, p. 15 (Order entered December 10, 2014).

In this Settlement, the parties have complied with the Commission's directive and have elected to utilize the TUS quarterly earnings report for DSIC ROE purposes. Similarly, the Company's Smart Meter Implementation Order states that, "To the extent that the subsequent base rate case is settled, the parties are to establish the applicable ROE to apply for the purposes of the Plan recovery mechanism in that proceeding."⁵⁰ As with the DSIC ROE stipulation, it is similarly appropriate to rely on the TUS quarterly earnings report to establish the applicable ROE for smart meter purposes.

B. Revenue Allocation and Rate Design (Joint Petition ¶ 11.B)

Pursuant to the Settlement, and as stated in the Joint Petition, the agreed to increase in base rates will allow the Company the opportunity to recover an increase of \$17,000,000 in revenue. The revenue allocation to each tariff and rate schedule is reflected in the Settlement Rates set forth in Exhibit 3 attached to the Joint Petition.⁵¹ The Joint Petition also states that the rate design for each tariff and rate schedule comprising the Settlement Rates is explained in Exhibit 4 attached to the Joint Petition.⁵² The allocations and rates set forth in Exhibits 3 and 4 and incorporated in the Settlement Rates reflect the Joint Petitioners' agreement with regard to rate structure, rate design and distribution of the settled upon \$17.0 million increase in revenues in this proceeding.⁵³

⁵⁰ *Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company for Approval of Smart Meter Technology Procurement and Installation Plan*, Docket No. M-2009-2123950, p. 30 (Order entered June 9, 2010).

⁵¹ Joint Petition, p. 9. *See also*, Joint Petition Exhibit 3 Revenue Allocation.

⁵² Joint Petition, p. 9. *See also*, Joint Petition Exhibit 4 Rate Design.

⁵³ Joint Petition, p. 9. *See also*, Joint Petition Exhibit 2 Proof of Revenue.

In this proceeding, as in all base rate case proceedings, I&E conducted a complete analysis of the Company's base rate filing, including a complete analysis of the cost of service study submitted by the Company, in order to offer recommendations of fair and reasonable increases in revenues and rate designs. One of the considerations I&E uses in establishing proposed rates is the resulting rate of return by customer class and the corresponding relative rate of return by class, i.e. how the rate of return for each class compares to the system average rate of return.⁵⁴ The optimum goal should be to establish proposed rates so that the revenue received from a particular class is equal to the corresponding costs of providing service to that class.⁵⁵ A relative rate of return above 1.00 for a class indicates that the cost of providing service is less than the revenue received from that class.⁵⁶ A relative rate of return below 1.00 for a class indicates that the cost of providing service is more than the revenue received from that class.⁵⁷ And, based on the results of I&E's analysis of the cost of service studies, I&E makes recommendations to move the relative rate of return for each class towards 1.00, which I&E considers the ultimate goal.⁵⁸ After a full and complete analysis of the Company's base rate case filing, including a full analysis of the cost of service studies, and the extensive settlement negotiations among the parties; I&E fully supports the revenue

⁵⁴ I&E St. No. 4, p. 33 at Docket No. R-2014-2428744.

⁵⁵ I&E St. No. 4, p. 33 at Docket No. R-2014-2428744.

⁵⁶ I&E St. No. 4, p. 33 at Docket No. R-2014-2428744.

⁵⁷ I&E St. No. 4, p. 33 at Docket No. R-2014-2428744.

⁵⁸ I&E St. No. 4, p. 35 at Docket No. R-2014-2428744.

allocations and rate design as set forth on Exhibits 2, 3 and 4 attached to the Joint Petition.⁵⁹

I&E notes that the Settlement results in a monthly residential distribution customer charge that will increase by \$1.96 (or 22.0%) from \$8.89 to \$10.85. This increase is in lieu of the Company's proposed monthly residential distribution customer charge contained in its filing of \$12.71, which represented a \$3.82 increase (or 43.0%). Additionally, under the Settlement rates, the bill for a typical Residential customer that uses 1,000 kWh per month will increase by \$7.80 per month, from \$104.76 to \$112.56 (or 7.4%), including default generation, taxes and surcharges. Whereas, under the Proposed rates, the bill for a typical Residential customer that uses 1,000 kWh per month would have increased by \$13.54 per month, from \$104.76 to \$118.30 (or 12.9%), including default generation, taxes and surcharges.

Therefore, in consideration of all of the above, I&E fully supports the settled upon revenue allocation and rates design as set forth in the Joint Petition.⁶⁰ I&E believes that the settled upon revenue allocations and rate design are consistent with prior Commission decisions; provide stability to Penn Power; represent a fair and reasonable rate increase to Penn Power customers; and provide protection from volatility; all of which are consistent with protecting the public interest.

⁵⁹ Joint Petition Exhibits 2, 3 and 4.

⁶⁰ Joint Petition Exhibits 2, 3 and 4.

III. THE SETTLEMENT SATISFIES THE PUBLIC INTEREST

14. I&E represents that all issues raised in testimony have been satisfactorily resolved through discovery and discussions with the Company or are incorporated or considered in the resolution proposed in the Settlement. The very nature of a settlement requires compromise on the part of all parties. This Settlement exemplifies the benefits to be derived from a negotiated approach to resolving what can appear at first blush to be irreconcilable regulatory differences. Joint Petitioners have carefully discussed and negotiated all issues raised in this proceeding, and specifically those addressed and resolved in this Settlement. Further line-by-line identification of the ultimate resolution of the disputed issues beyond those presented in the Settlement is not necessary as I&E represents that the Settlement maintains the proper balance of the interests of all parties. I&E is satisfied that no further action is necessary and considers its investigation of this rate filing complete.

15. Based upon I&E's analysis of the filing, acceptance of this proposed Settlement is in the public interest. Resolution of this case by settlement rather than litigation will avoid the substantial time and effort involved in continuing to formally pursue all issues in this proceeding at the risk of accumulating excessive expense.

16. I&E further submits that the acceptance of this Settlement will negate the need for evidentiary hearings, which would compel the extensive devotion of time and expense for the preparation, presentation, and cross-examination of multiple witnesses, the preparation of Main and Reply Briefs, the preparation of Exceptions and Replies, and

the potential of filed appeals, all yielding substantial savings for all parties, and ultimately all customers, as well as certainty on the regulatory disposition of issues.

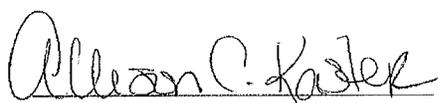
17. The Settlement is conditioned upon the Commission's approval of all terms without modification. Should the Commission fail to grant such approval or otherwise modify the terms and conditions of the Settlement in any way, it may be withdrawn by the Company, I&E, or any other Joint Petitioner.

18. I&E's agreement to settle this case is made without any admission or prejudice to any position that I&E might adopt during subsequent litigation in the event that the Settlement is rejected by the Commission or otherwise properly withdrawn by any other parties to the Settlement.

19. If the ALJs recommend that the Commission adopt the Settlement as proposed, I&E agrees to waive the filing of Exceptions. However, I&E does not waive its right to file Replies to Exceptions with respect to any modifications to the terms and conditions of the Settlement or any additional matters that may be proposed by the ALJ in the Recommended Decision. I&E also does not waive the right to file Replies in the event any party files Exceptions.

WHEREFORE, the Commission's Bureau of Investigation and Enforcement represents that it supports the Joint Petition for Settlement as being in the public interest and respectfully requests that Administrative Law Judges Dennis Buckley and Katrina Dunderdale recommend, and the Commission approve, the terms and conditions contained in the Settlement.

Respectfully submitted,



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Dated: February 3, 2015

Statement E

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
	:	
V.	:	Docket Nos. R-2014-2428744
	:	M-2013-2341993
	:	
PENNSYLVANIA POWER COMPANY	:	

**STATEMENT IN SUPPORT OF THE
PENN POWER USERS GROUPS**

The Penn Power Users Group ("PPUG"), by and through its counsel, submits that the Joint Petition for Partial Settlement ("Joint Petition" or "Settlement"), filed in the above-captioned proceeding with the Pennsylvania Public Utility Commission ("PUC" or "Commission"), reflects a settlement among the Joint Petitioners with respect to Pennsylvania Power Company's ("Penn Power" or "Company") August 4, 2014, filing of Tariff Electric – Pa. P.U.C. No. 36, which sought to increase Penn Power's total annual operating revenues by \$28.5 million. As a result of settlement discussions, Penn Power, PPUG, the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the PUC Bureau of Investigation and Enforcement ("I&E"), Wal-Mart Stores East, LP and Sam's East, Inc. (collectively, "Walmart"), and the Environmental Defense Fund ("EDF") (collectively, "Parties" or "Joint Petitioners") have agreed upon the terms embodied in the foregoing Joint Petition. PPUG offers this Statement in Support to further demonstrate that the Settlement is in the public interest and should be approved without modification.

I. BACKGROUND

1. On August 4, 2014, Penn Power filed Tariff Electric – Pa. P.U.C. No. 36 ("Tariff 36"), and Supplements thereto, which contained proposed changes in rates, rules, and regulations calculated to produce approximately \$28.5 million, or 8.7%, in additional revenues.

2. On September 12, 2014, PPUG submitted a Joint Complaint at Docket No. C-2014-2442357.¹ As noted in Paragraph 10 of the Joint Complaint, PPUG members are some of Penn Power's largest customers, purchasing service from Penn Power primarily under Rate Schedule GT, as well as available riders. As such, PPUG members were concerned that the distribution rates paid by PPUG members, as well as the terms and conditions of service offered to PPUG members, would be adversely impacted as a result of Penn Power's base rate filing.

3. A Prehearing Conference was held on October 8, 2014, before presiding Administrative Law Judges ("ALJs") Dennis J. Buckley and Katrina L. Dunderdale, at which time the procedural schedule and the conduct of evidentiary and public input hearings were established.

4. On or about January 9, 2015, the Parties informed the ALJs that a partial settlement in principle had been reached resolving the majority of the issues in this proceeding.² A hearing was held on January 14, 2015, at which time all parties' testimony was entered into the evidentiary record. The ALJs directed the Joint Petitioners to submit the Joint Petition and accompanying Statements in Support by February 3, 2015.

¹ The Joint Complaint was filed by PPUG, the Met-Ed Industrial Users Group ("Met-Ed"), and the Penelec Industrial Customer Alliance ("PICA"), such that the Complaint was lodged in this proceeding with respect to PPUG and at the applicable dockets for the Pennsylvania Electric Company ("Penelec") and the Metropolitan-Edison Company ("Met-Ed"), with respect to PICA and MEIUG, respectively.

² The Settlement does not resolve the issue raised by Citizens for Pennsylvania's Future ("PennFuture") regarding the scope and pricing of Penelec's proposed LED street lighting Rider. This issue is reserved for briefing. PPUG has no position on this issue.

II. STATEMENT IN SUPPORT

5. The Commission has a strong policy favoring settlements. As set forth in the PUC's regulations, "[t]he Commission encourages parties to seek negotiated settlements of contested proceedings in lieu of incurring the time, expense and uncertainty of litigation." 52 Pa. Code § 69.391; *see also* 52 Pa. Code § 5.231. Consistent with the Commission's Policy, the Joint Petitioners engaged in negotiations to resolve the issues raised by various parties. These ongoing discussions produced the foregoing Settlement.

6. The Joint Petitioners agree that approval of the proposed Settlement is in the best interest of the parties involved.

7. The Joint Petitioners agree that the Company should be authorized to file a tariff supplement containing the rates set forth in the Joint Petition.

8. The Joint Petitioners agree that the \$17 million rate increase achieved in the Joint Petition is just, reasonable, and in the public interest.

9. The Joint Petitioners agree that this resulting rate increase should be allocated pursuant to the terms of the Settlement.

10. The Joint Petition is in the public interest for the following reasons:

- a. As a result of the Joint Petition, expenses incurred by the Joint Petitioners and the Commission for completing this proceeding will be less than they would have been if the proceeding had been fully litigated.
- b. Uncertainties regarding further expenses associated with possible appeals from the Final Order of the Commission are avoided as a result of the Joint Petition.
- c. The Joint Petition results in an increase in Penn Power's rates by \$17 million, which is approximately 59.6% of the Company's original request of \$28.5 million.
- d. While the Joint Petition reflects a "black box settlement," which often is the means used to achieve settlement among parties with respect to Rate of Return

and Return on Equity issues in a rate proceeding, the Joint Petition addresses concerns about the absence of a stated rate of return on equity by affirmatively establishing a reasonable approach to determine a rate of return on equity for Penn Power if a distribution system improvement charge is hereafter proposed by Penn Power and approved by the Commission as well as the means by which to calculate the incremental revenue requirement associated with smart meter deployment that exceeds the smart meter revenue requirement being recovered through settlement rates and is therefore eligible for recovery through the Company's Smart Meter Technologies Charge.

- e. The Joint Petition provides an appropriate means by which to allocate the resulting increase among the Penn Power customer classes.
- f. The Joint Petition provides a just and reasonable manner of resolving the Company's claim for deferred storm damage expenses and future storm expenses.
- g. The Joint Petition reflects compromises on all sides presented without prejudice to any position any Joint Petitioner may have advanced so far in this proceeding. Similarly, the Joint Petition is presented without prejudice to any position any party may advance in future proceedings involving the Company.

11. In addition, the Joint Petition specifically satisfies the concerns of PPUG by: (1) lowering the revenue increase amount by approximately 40.4%; (2) appropriately allocating the proposed increase among the customer classes; and (3) eliminating the proposed Storm Rider.

12. PPUG supports the foregoing Joint Petition because it is in the public interest; however, in the event that the Joint Petition is rejected by the ALJs or the Commission, PPUG will resume its litigation position, which differs from the terms of the Joint Petition.

13. As set forth above, PPUG submits that the Settlement is in the public interest and adheres to Commission policies promoting negotiated settlements. The Settlement was achieved after numerous settlement discussions. Although Joint Petitioners have invested time and resources in the negotiation of the Joint Petition, this process has allowed the parties, and the Commission, to avoid expending the substantial resources that would have been required to fully

litigate this proceeding while still reaching a just, reasonable, and non-discriminatory result. Joint Petitioners have thus reached an amicable solution to this dispute as embodied in the Settlement. Approval of the Settlement will permit the Commission and Joint Petitioners to avoid incurring the additional time, expense, and uncertainty of further litigation of a number of major issues in this proceeding. *See* 52 Pa. Code § 69.391.

III. CONCLUSION

WHEREFORE, the Penn Power Users Group respectfully requests that the Administrative Law Judges and the Commission approve the Joint Petition for Settlement without modification.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By 
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Counsel to the Penn Power Users Group

Dated: February 3, 2015

Statement F

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION)	
)	
)	
)	Docket No. R-2014-2428744
v.)	
)	
)	
PENNSYLVANIA POWER COMPANY)	

**STATEMENT IN SUPPORT OF SETTLEMENT OF
ENVIRONMENTAL DEFENSE FUND**

TO THE HONORABLE DENNIS J. BUCKLEY AND KATRINA L. DUNDERDALE,
PRESIDING ADMINISTRATIVE LAW JUDGES:

AND NOW, comes Environmental Defense Fund (“EDF”) hereby submitting its Statement in Support of the Joint Petition for Partial Settlement of Rate Investigation (“Settlement”) being filed simultaneously herewith. EDF believes that this Settlement is in the public interest and should be approved by the Pennsylvania Public Utility Commission (“Commission”) as presented and hereby requests such relief. In support thereof, EDF states and avers as follows:

I. BACKGROUND

This proceeding began on or about August 4, 2014, when FirstEnergy utilities (jointly, the “FirstEnergy Utilities”) Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”), Pennsylvania Power Company (“Penn Power”), and West Penn Power Company (“West Penn”) filed to the Commission electric tariffs, requesting an increase in distribution rates.

On October 2, 2014, the Commission adopted an Order (“Suspension Order”) suspending each tariff filings and referring the same to the Office of Administrative Law Judge for investigation to determine the lawfulness, justness, and reasonableness of the rates, rules, and regulations proposed by the FirstEnergy Utilities.

EDF filed a timely Petition to Intervene on October 3, 2014, jointly with Citizens for Pennsylvania’s Future (“PennFuture”), which the Commission granted (“Joint Petition”). The Joint Petition summarized EDF’s interest in the case, specifically identifying but not limiting this interest as including distribution grid planning and modernization, smart grid planning and functionality, LED lighting, third party access to energy usage data, and customer utilization of advanced grid functionality.

A prehearing conference was held on October 8, 2014, at which a schedule was established for submission of testimony, evidence, and public input hearings.

On November 24, 2014, EDF, in accordance with the previously established schedule, filed direct testimony and accompanying exhibits. This testimony included a number of recommendations, including recommendation relating to Volt/Var Control technology, integrated resource planning, energy usage data for customers and authorized third parties, and the use of environmental and performance metrics to measure utility performance.

On December 18, 2014, the FirstEnergy utilities filed rebuttal testimony and accompanying exhibits. On January 6, 2015, EDF filed surrebuttal testimony on a number of issues, including those related to customer and third party access to energy usage data and environmental and performance metrics that can measure utility performance.

Negotiations were conducted in an effort to achieve a settlement of the issues in this case. As a result, EDF was able to agree to the Settlement, which resolves all issues identified in the

Settlement. In light of the Settlement, hearings held on January 14, 2015 solely focused on entering testimony and exhibits into the record.

II. STATEMENT IN SUPPORT

The Settlement contains a number of conditions which are intended to address the concerns raised by EDF throughout the course of this proceeding. The following identified issues are those of principal interest to EDF and in the public interest:

- The FirstEnergy utilities will report on the following metrics: Home area network devices; AMI meter installs, reductions in greenhouse gas emissions, and voltage and VAR controls.
- The FirstEnergy utilities will meet with EDF and any other interested statutory parties in respect to smart meter and smart grid deployment efforts, including discussion of customer data access, Volt/VAR best practices, and measuring GHG emission reductions.

WHEREFORE, EDF respectfully requests that the Commission approve the Settlement as presented, without modification, and with all due haste.

Respectfully submitted,



Michael Panfil
Attorney

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Dated: February 3, 2015

Statement G

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	Docket Nos.	R-2014-2428744
	:		M-2013-2341993
v.	:		
	:		
Pennsylvania Power Company	:		
	:		

**STATEMENT OF INTERVENORS
WAL-MART STORES EAST, LP AND SAM’S EAST, INC.
IN SUPPORT OF JOINT PETITION FOR PARTIAL SETTLEMENT
OF RATE INVESTIGATION**

**TO THE HONORABLE DENNIS J. BUCKLEY AND KATRINA L. DUNDERDALE,
ADMINISTRATIVE LAW JUDGES:**

I. INTRODUCTION

1. Wal-Mart Stores East, LP and Sam’s East, Inc. (collectively, “Walmart”), hereby respectfully, by and through its counsel, submits that the Joint Petition for Partial Settlement of Rate Investigation (“Joint Petition”) filed in the above-captioned proceeding by Pennsylvania Power Company (“Penn Power” or the “Company”), the Office of Consumer Advocate (“OCA”), the Office of Small Business Advocate (“OSBA”), the Bureau of Investigation and Enforcement (“I&E”), the Penn Power Users Group (“PPUG”), Walmart, and the Environmental Defense Fund (“EDF”) (collectively, the “Joint Petitioners”), by their respective counsel, is in the public interest and represents a reasonable partial resolution of the issues set forth in the Joint Petition (the “Partial Settlement”).

2. While the Partial Settlement does not address all of Walmart’s concerns as stated in this proceeding and in the manner preferred by Walmart, the Partial Settlement, taken as a

whole, reflects a reasonable compromise amongst numerous competing interests and positions representing a wide range of rate classes. In support of the Joint Petition and Partial Settlement, Walmart provides the within Statement in Support of the Partial Settlement and respectfully requests that the terms and conditions of the Partial Settlement be approved by Administrative Law Judges Dennis J. Buckley and Katrina L. Dunderdale and the Pennsylvania Public Utility Commission (“Commission”) without modification.

II. BACKGROUND

3. The background set forth in Paragraphs 1 through 10 of Section I. (Background) of the Joint Petition is incorporated herein by reference as if set forth in its entirety.

III. STATEMENT IN SUPPORT OF THE PARTIAL SETTLEMENT

4. The Commission, as a matter of policy, encourages settlements. *See* 52 Pa. Code § 5.231. Settlements conserve administrative resources and reduce the uncertainty, time and considerable expense associated with litigating the issues in a proceeding. Moreover, the Commission has stated, that in its judgment, the results achieved from a negotiated settlement in which the interested parties have had an opportunity to participate are often preferable to those achieved at the conclusion of a fully litigated proceeding. *See* 52 Pa. Code § 69.401.

5. The standard of review when determining whether a settlement should be approved is whether the settlement promotes the public interest. *See Pa. Pub. Util. Comm’n. v. York Water Co.*, Docket No. R-00049165 (October 4, 2004); *Pa. Pub. Util. Comm’n. v. C.S. Water & Sewer Associates*, 74 Pa. PUC 767 (1991); *Pa. Pub. Util. Comm’n. v. Philadelphia Electric Company*, 60 Pa. PUC 1 (1985).

6. Counsel for the Company, Walmart and the other Joint Petitioners, as well as other parties, participated in a lengthy and extensive investigation of the Company's August 4, 2014 Distribution Base Rate Filing (the "Distribution Base Rate Filing") in this proceeding, which investigation included substantial discovery and the submission of numerous written interrogatories and voluminous responses thereto and written direct, rebuttal, surrebuttal and rejoinder testimony.

7. Over a period of several weeks, counsel for the Company, Walmart and the other Joint Petitioners, as well as other parties, participated in lengthy and extensive discussions and negotiations that resulted in the proposed amicable resolution of all but one of the many complex issues raised in the Distribution Base Rate Filing.

8. As an Intervenor, Walmart recommended that the Commission consider the impact on customers thoroughly and carefully to ensure that any increase in the Company's rates are only the minimum amount necessary for the utilities to provide adequate and reliable service. Additionally, Walmart recommended that the Commission closely examine the Company's proposed revenue requirement increase, especially when viewed in light of the proposed use of a fully projected future test year. This issue is addressed in the Partial Settlement. In its Distribution Base Rate Filing, the Company proposed a distribution base rate operating revenue increase of approximately \$29.557 million. *See Penn Power Statement No. 1*, page 8. Pursuant to the terms of the Partial Settlement, the negotiated rate schedules were designed to produce an increase in base rate operating revenues of approximately \$17 million for the twelve-month period ending April 30, 2016. (*See Joint Petition*, p. 6).

9. With respect to rate design, Walmart advocated that distribution rates be set based on the utility's cost of service, which has the effect of producing equitable rates that reflect cost

causation, sending proper price signals to customers and minimizing price distortions. Pursuant to the terms of the Partial Settlement, the revenue allocation to each rate schedule reflected in the Settlement Rates is set forth in Exhibit 3 to the Joint Petition and rate design for each rate schedule comprising the Settlement Rates is provided in Exhibit 4 to the Joint Petition. The allocations and rates set forth in Exhibits 3 and 4 and incorporated in the Settlement Rates reflect significant negotiation among the Joint Petitioners and reflect the Joint Petitioners' agreement with regard to rate structure, rate design and distribution of the increase in revenues in this proceeding. In general, the revenue allocations and rates as set forth in the Joint Petition reflect a reasonable compromise among competing interests to move towards cost of service.

10. The terms of the Partial Settlement are supported by the testimony entered into the record and there is, therefore, a sound evidentiary basis for the Partial Settlement terms.

11. Therefore, the Partial Settlement is in the public interest because:

(a) Settlements conserve administrative resources and reduce the uncertainty, time and considerable expense associated with fully litigating the issues in a proceeding.

(b) The results achieved from a negotiated settlement in which the interested parties have had an opportunity to participate are often preferable to those achieved at the conclusion of a fully litigated proceeding.

(c) It provides for an increase in annual base rate distribution revenues of \$17 million, or approximately 5.2% (based on total electric operating revenue), in lieu of the \$29.557 million, or approximately 9.0% (based on total electric operating revenue) increase originally requested by the Company.

(d) In general, the revenue allocations and rates as set forth in the Joint Petition reflect a reasonable compromise among competing interests to move towards cost of service.

(e) It was reached after extensive investigation which included substantial discovery and the submission of numerous written interrogatories and voluminous responses thereto and written direct, rebuttal, surrebuttal and rejoinder testimony.

(f) It was reached after the Joint Petitioners participated in lengthy and extensive discussions and negotiations that resulted in the proposed amicable resolution of all but one of the many complex issues raised in the proceeding.

(g) There is a sound evidentiary basis for the Partial Settlement terms.

12. Walmart's support of the Joint Petition and the Partial Settlement does not imply Walmart's agreement with each and every aspect of the Partial Settlement on an individual term-by-term basis. Rather, Walmart's support of the Joint Petition and the Partial Settlement, taken as a whole, is based on the premise that the Partial Settlement represents a reasonable compromise amongst numerous competing interests and positions in the Distribution Base Rate Filing. Settlement of the numerous complex issues by the parties avoids the uncertainty involved in litigation and the necessity of further costly administrative, and possibly appellate, proceedings regarding the issues resolved the Partial Settlement.

III. CONCLUSION

WHEREFORE, Walmart respectfully requests that Administrative Law Judges Dennis J. Buckley and Katrina L. Dunderdale recommend without modification, and the Commission

subsequently approve without modification, the foregoing Joint Petition for Partial Settlement of Rate Investigation.

Respectfully submitted,

STEVENS & LEE



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Attorneys for Wal-Mart Stores East, LP and Sam's East, Inc.

Dated: February 3, 2015

Letter of Non-Opposition and Support



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February 3, 2015

BY ELECTRONIC FILING

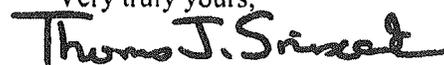
Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street – Filing Room
Harrisburg, PA 17120

RE: Pennsylvania Public Utility Commission v. Pennsylvania Power Company; Docket No. R-2014-2428744; **LETTER OF THE PENNSYLVANIA STATE UNIVERSITY OF NON-OPPOSITION TO THE JOINT PETITION FOR PARTIAL SETTLEMENT**

Dear Secretary Chiavetta:

The Pennsylvania State University (PSU) is a party to the above-captioned matter (it did not participate in the Smart Meter matter) and has reviewed the terms and conditions of the Joint Petition for Partial Settlement (Joint Petition) filed today. PSU has not signed the Settlement as it did not present evidence in the matter. However, PSU does not oppose the Settlement and supports it as being in the public interest for the reasons stated in the Joint Petition and respectfully asks Judges Buckley and Dunderdale and the Commission to approve it without modification.

Thank you for your consideration and PSU commends the Joint Petitioners for achieving an amicable and just and reasonable resolution of the issues involved.

Very truly yours,


Thomas J. Sniscak
William E. Lehman

Counsel to The Pennsylvania State University

TJS/das
Enclosure

cc: Honorable Dennis J. Buckley
Honorable Katrina Dunderdale
Per Certificate of Service

MAILING ADDRESS: P.O. BOX 1778 HARRISBURG, PA 17105

Letter of Non-Opposition and Support

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION		Docket Nos. R-2014-428744 M-2013-2341993
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v.

PENNSYLVANIA POWER COMPANY		
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**STATEMENT OF THE COALITION FOR AFFORDABLE UTILITY SERVICES
AND ENERGY EFFICIENCY IN PENNSYLVANIA OF NON-OPPOSITION
TO THE JOINT PETITION FOR PARTIAL SETTLEMENT**

The Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania (“CAUSE-PA”), one of the Interveners to the above docketed rate proceeding, has submitted no testimony in this matter, and although it is not a signatory to the Joint Petition for Settlement, it has no opposition to the that Settlement. Furthermore, CAUSE-PA respectfully submits that terms of the proposed Settlement reflect a carefully balanced compromise of interests; that settlement will save costs and time to ratepayers, the Company and the Commission; and are in the public interest.

PENNSYLVANIA UTILITY LAW PROJECT



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Date: February 3, 2015

*For: Coalition for Affordable Utility Services
and Energy Efficiency in Pennsylvania*