ANNUAL REPORT

OF THE

PENNSYLVANIA
OFFICE OF SMALL BUSINESS ADVOCATE

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I. INTRODUCTION

Business and residential customers generally have a similar interest in keeping a proposed utility rate increase as small as possible. However, their interests often conflict on the issue of rate structure, *i.e.*, the share of a rate increase to be borne by each particular category of customer.

Historically, the Attorney General's Office of Consumer Advocate ("OCA") has represented residential ratepayers in rate structure disputes. Furthermore, large commercial and industrial customers frequently have had their own attorneys and expert witnesses. In contrast, because they did not have—and could not afford—their own representation, small business customers often received a disproportionate share of the rate increase. The legislature sought to level the playing field by creating the Office of Small Business Advocate ("OSBA").

The OSBA operates under the act of December 21, 1988 (P. L. 1871, No. 181), known as the Small Business Advocate Act, 73 P.S. §§399.41 *et seq.* (the "Act").

The Act directs the OSBA to represent the interests of small business consumers of utility services before the Pennsylvania Public Utility Commission (the "PUC" or "Commission"), before comparable federal agencies, and in the courts. For purposes of the Act, a small business consumer is defined as "a person, sole proprietorship, partnership, corporation, association or other business entity which employs fewer than 250 employees and which receives public utility service under a small commercial, small industrial or small business rate classification."

Small business customers usually take service in rate classes designated by the utilities for small commercial and industrial ("Small C&I") customers, medium commercial and industrial ("Medium C&I") customers, or Commercial customers.

Under the Act, the Small Business Advocate is granted broad discretion concerning whether or not to participate in particular proceedings before the PUC. In exercising that discretion, the Small Business Advocate is to consider the public interest, the resources available, and the substantiality of the effect of the particular proceeding on the interests of small business consumers.

The OSBA is administratively included within the Department of Community and Economic Development ("DCED"). However, the Act specifically provides that the Secretary of DCED is not in any way responsible for the policies, procedures, or other substantive matters developed by the OSBA to carry out its duties under the Act.

Because of the office's success in utility litigation, additional duties were assigned to the OSBA as part of the 1993 reforms to Pennsylvania's Workers' Compensation Act. Specifically, Article XIII of that revised statute, 77 P.S. §§1041.1 *et seq.*, authorizes the

Small Business Advocate to represent the interest of employers in proceedings before the Insurance Department that involve filings made by insurance companies and rating organizations with respect to the premiums charged for workers' compensation insurance policies. Those duties require the Small Business Advocate to review the "loss cost" filings that are made each year by the Pennsylvania Compensation Rating Bureau and the Coal Mine Compensation Rating Bureau of Pennsylvania.

The OSBA's budget for fiscal year 2011-2012 is $1,286,000. That budget is funded by assessments on utilities and on workers' compensation insurers, in proportion to the office's expenses in relation to each group. At the present time, utility company assessments account for about 85% of the budget and insurance company assessments for about 15%. None of the OSBA's budget is financed by General Fund tax revenue.

The OSBA's authorized employee complement consists of seven persons, including five attorneys (the Small Business Advocate and four Assistant Small Business Advocates) and two support staff personnel.

Steven C. Gray has been serving as the Acting Small Business Advocate since November 16, 2011.

II. THE UTILITY RATEMAKING PROCESS

Historically, utility companies have been viewed as natural monopolies which, in the absence of regulation, could charge excessive rates to their customers. Under the Public Utility Code, the PUC is responsible for setting rates which are "just and reasonable," *i.e.*, rates which cover the utility's costs and provide an opportunity for the utility to earn a fair profit.

Under the traditional ratemaking process, the PUC first measures the dollar amount of the utility's investment, *e.g.*, the utility's physical plant. Then, the PUC determines the return on that investment which will enable the company to service its debt and offer a stock price and dividends which are sufficient to attract equity investors. Next, the Commission awards the utility a rate increase in an amount which yields the required return on investment (after the utility has paid its operating expenses). Finally, the PUC decides how much of the rate increase is to be paid by each class of customers, *e.g.*, residential, small commercial and industrial, and large commercial and industrial.

In an appeal brought by the OSBA, the Commonwealth Court held "that rates and rate structures [must] be set for each service primarily on a cost-of-service study." *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006), *appeals denied,* 916 A.2d 1104 (Pa. 2007). Although the Court indicated that the Commission may consider other factors, such as gradualism, the Court characterized cost of service as the "polestar" of ratemaking concerns. In addition, the Court stated that gradualism may not be permitted to trump cost of service and that, whenever gradualism is successfully invoked, there must be a plan to move rates to cost of service gradually, *e.g.*, a multi-year phase-out of any subsidy provided by small commercial and industrial customers to residential customers.

Although the Commission continues to regulate water and wastewater utilities largely through the traditional ratemaking process, Pennsylvania has departed significantly from that process with regard to telephone, electric, and gas service. This departure is in response to changing federal requirements and to three statutes enacted by the General Assembly in the 1990s.

First, a 1993 state law (commonly referred to as "Chapter 30") ended rate regulation of those telecommunications services for which there was deemed to be competition. Furthermore, Chapter 30 provided for the similar deregulation of additional services if competitive markets develop.

In addition to deregulating certain services, Chapter 30 required the local telephone company to deploy high-speed broadband throughout its service area. To help pay for the broadband deployment, the utility was allowed to increase its rates for non-competitive services each year in an amount roughly equivalent to the rate of inflation less a productivity adjustment. These annual price increases are commonly referred to as

"Price Change Opportunities," or "PCOs." A 2004 state law reenacted Chapter 30 and provided for larger annual rate increases as an incentive to accelerate broadband deployment.

Second, a 1996 state law (which was amended in 2008) ended traditional regulation of the portion of the electric rate which covers the cost of generating electricity. After a transition period, the generation rates charged by the utility are to be based on the competitive procurement of electricity in the market place.[1] Customers who are not satisfied with the utility's generation rates also have the opportunity to buy their electricity from power plants other than those selected by the utility. However, the charge for transporting the electricity from the power plant to the utility's service territory (the "transmission rate") and the charge for delivering that electricity from the transmission line to the customer's premises (the "distribution rate") remain subject to traditional ratemaking.

Third, a 1999 state law gave all customers the right to buy natural gas from either the local utility or a competitor of the local utility. If a customer chooses to buy from the local utility, the rate for that service is set by the PUC after a review to assure that the utility is paying the "least cost" for the gas and for the transportation of the gas from the well to the utility's service territory. However, regardless of whether the customer buys gas from the utility or from a competitor, the utility remains responsible for delivering the gas from the interstate pipeline or the local gas well to the customer's premises. The PUC sets that delivery (or "distribution") rate through the traditional ratemaking process.

[1] Under the 1996 statute, the utility was required to acquire the electricity at "prevailing market prices." However, the 2008 amendments repealed the "prevailing market prices" standard and imposed the requirement that the utility acquire the electricity competitively through a "prudent mix" of contracts and at the "least cost to customers over time." The 2008 amendments also prohibited any interclass subsidization, *e.g.*, small commercial and industrial ratepayers cannot be required to pay an above-market price for electricity so that residential or large commercial and industrial customers can pay a below-market price.

III. UTILITY MERGERS AND ACQUISITIONS

Approval from the PUC is required before a Pennsylvania utility may be sold to, acquired by, or merged with another utility or a non-utility. In general, Commission approval is contingent upon a finding that the proposed transaction would result in "affirmative benefits" to the public.

Specifically, Section 1102(a) of the Public Utility Code, 66 Pa. C.S. § 1102(a), requires that the Commission issue a certificate of public convenience as a legal prerequisite for the transfer or acquisition of certain property. The statute provides, in pertinent part:

> (a) Upon the application of any public utility and the approval of such application by the commission, evidenced by its certificate of public convenience first had and obtained, and upon compliance with existing laws, it shall be lawful:
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> * * *
>
> (3) For any public utility or an affiliated interest of a public utility as defined in section 2101 … to acquire from, or to transfer to, any person or corporation, including a municipal corporation, by any method or device whatsoever, including the sale or transfer of stock and including a consolidation, merger, sale or lease, the title to, or the possession or use of, any tangible or intangible property used or useful in the public service….

66 Pa. C.S. § 1102(a)(3).

Section 1103(a) of the Public Utility Code provides, in pertinent part:

> A certificate of public convenience shall be granted by order of the commission, only if the commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public.

66 Pa. C.S. § 1103(a).

In *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 295 A.2d 825 (Pa. 1972), the Pennsylvania Supreme Court provided the legal standard for granting a certificate under Section 1103(a) in public utility merger and acquisition cases. Specifically, the Supreme Court stated:

> [A] certificate of public convenience approving a merger is not to be granted unless the Commission is able to find affirmatively that public benefit will result from the merger .... [T]hose seeking approval of a utility merger [are required to] demonstrate more than the mere absence of any adverse effect upon the public .... [T]he proponents of a merger [are required to] demonstrate that the merger will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way.

City of York, 449 Pa. at 141, 295 A.2d at 828.[2]

Under Section 1103(a), "[t]he commission, in granting such certificate [of public convenience], may impose such conditions as it may deem to be just and reasonable." Consistent with Section 1103(a), the PUC has held that "[i]n order to ensure that a proposed merger is in the 'public interest,' the Commission may impose conditions on its granting of the certificate of public convenience." *Joint Application for Approval of the Merger of GPU, Inc. with FirstEnergy Corp.*, Docket No. A-110300F0095, 2001 Pa. PUC Lexis 23 (Order entered June 20, 2001). Consequently, by imposing conditions pursuant to Section 1103(a), the PUC may approve a transaction which would not meet the *City of York* standard without those conditions.

Moreover, the Pennsylvania Supreme Court applied Section 1103(a) in deciding the appeal of the Commission's decision regarding the Verizon/MCI merger. *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 937 A.2d 1040 (Pa. 2007). The Supreme Court ruled that "while in some circumstances conditions may be necessary to satisfy the Commission that public benefit sufficient to meet the requirement of Section 1103(a) will ensue, even where the PUC finds benefit in the first instance, Section 1103(a) also confers discretion upon the agency to impose conditions which it deems to be just and reasonable." *Popowsky*, 937 A.2d at 1057.

Through its ruling in *Popowsky*, the Supreme Court provided further guidance on what the Commission is required to review in a merger or acquisition case. The Court opined that "the appropriate legal framework requires a reviewing court to determine whether substantial evidence supports the Commission's finding that a merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way. In conducting the underlying inquiry, the Commission is not required to secure legally binding commitments or to quantify benefits where this may be impractical, burdensome, or impossible; rather, the PUC properly applies a preponderance of the evidence standard to make factually-based determinations

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[2] Although *City of York* involved a merger, its holding is equally applicable to an acquisition. Section 1102(a)(3), which imposes the certificate of public convenience requirement, makes no distinction based on whether property is acquired by the "sale or transfer of stock," a "consolidation," a "merger," a "sale," or a "lease."

(including predictive ones informed by expert judgment) concerning certification matters." *Popowsky*, 937 A.2d at 1057. In other words, the proponents of the transaction are required to prove the likelihood of *substantial* affirmative public benefits by a preponderance of the evidence.

In *City of York*, 449 Pa. at 141, 295 A.2d at 828, the Supreme Court stated the test as follows:

> [T]he proponents of a merger [are required to] demonstrate that the merger will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some *substantial* way. (emphasis added)

In both *City of York* and *Popowsky*, the Supreme Court simply concluded that there was substantial evidence to support the Commission's finding that the proposed transaction would provide affirmative public benefits. The Supreme Court did not hold that it would have been erroneous if the Commission had found that those benefits were not "substantial" and, therefore, did not justify approval of the transaction.

In other words, even if the Commission finds by a preponderance of evidence, that a proposed transaction would yield affirmative public benefits, the Commission is not permitted to approve that transaction unless it finds that the benefits would be *substantial*.

IV. THE OSBA'S PUC-RELATED ACTIVITIES

The OSBA participates before the PUC in major rate cases, merger cases, and other non-rate proceedings that have a significant impact on small commercial and industrial ("Small C&I") customers. The following is a summary of some of the most significant cases in which the OSBA was active in 2011. The case summaries set forth below are current as of mid-February, 2012.

A. Electric Highlights

The rates charged by an electric distribution company ("EDC") include the cost of generating electricity (the "generation rate"), the cost of transporting that electricity from the power plant to the EDC's service territory (the "transmission rate"), and the cost of delivering that electricity through the EDC's wires to customers' premises (the "distribution rate").

Pennsylvania EDCs no longer generate electricity. Therefore, an EDC is required to purchase electricity from generators and transport it to the service territory in order to serve the EDC's non-shopping, *i.e.*, default service, customers. The EDC is required to deliver that electricity through the EDC's wires to its default service customers and also to deliver electricity through those wires which shopping customers have bought from electric generation suppliers ("EGSs").

1. Transmission and Distribution Rates

Citizens' Electric Company
Distribution Rate Increase
Docket No. R-2010-2172665

On June 2, 2010, Citizens' Electric Company ("Citizens'" or the "Company") filed a proposed tariff to increase its total electric distribution revenues by approximately $787,276 per year, *i.e.*, by 21.5%. The Company's proposed rate increase would have produced an 11.75% rate of return on equity ("ROE").

The OSBA filed a complaint and testimony against the proposed rate increase.

Ultimately, the parties (other than Bucknell University) negotiated a settlement of all issues. The following provisions were of particular significance to the OSBA in concluding that the settlement was in the best interests of small business customers:

First, Citizens' agreed to reduce the rate increase to $600,000 per year. That provision of the settlement was consistent with the OSBA's argument that the Company's requested ROE was excessive.

Second, the settlement resolved the OSBA's concern with Citizens' proposal to implement a Direct Load Control ("DLC") program. As proposed, this pilot program was to be open to customers in the residential (RS) and small commercial (GLP-1) rate classes but not to customers in any other class. However, the Company proposed to recover the costs associated with the DLC program through its Generation Service Supply Rate ("GSSR"), which is paid by *all* default service customers, regardless of class. Therefore, the OSBA objected to the use of the GSSR as the mechanism for recovery of the DLC costs because those costs should be recovered solely from the classes, *i.e.*, RS and GLP-1, for which the costs were incurred. The settlement allowed the Company to implement the DLC pilot but to recover the costs through the distribution rates of the RS and GLP-1 classes rather than through the GSSR.

Third, Citizens' proposed a revenue allocation that purportedly moved all major rate classes closer to cost of service as measured by the Company's cost of service study ("COSS"). The OSBA took the position that, while the Company's proposal was reasonable at the full requested revenue requirement level, the rates of return for the GLP-1, GLP-3, and Outdoor Lighting classes would be in excess of 13.0% even though the system average would be only 9.41%. To rectify this problem, the OSBA recommended that these three classes (GLP-1, GLP-3, and Outdoor Lighting) be granted first dollar relief ("FDR") in the event that the Company was awarded a smaller rate increase than requested.

In contrast, the OCA performed its own COSS and proposed a new revenue allocation on the basis of that COSS. Under the OCA's proposal, the GLP-1, GLP-3, and Outdoor Lighting classes would have provided rates of return significantly in excess of the system average (as measured by the OCA's COSS) even if the original rate increase were reduced.

The settlement revenue allocation was a compromise that fell between the revenue allocation proposals of the OSBA and the other parties. As a result of the compromise, the GLP-1, GLP-3, and Outdoor Lighting classes received a distribution rate increase well below the system average increase of 16.32%. Specifically, GLP-1 received a 1.32% increase, GLP-3 received a 4.34% increase, and Outdoor Lighting received a 2.5% increase. As a result, the small business GLP-1 and GLP-3 classes will save about $124,000 per year in comparison to the amount they would have paid under the OCA's proposal.

Fourth, Citizens' proposed implementing a monthly customer charge for GLP-1 of $14.00. Citizens' provided information to reflect that it incurs direct customer costs of only $13.22 per month to serve GLP-1 customers. However, the Company provided no cost-based justification for the difference between its actual costs and the proposed customer charge of $14.00. Therefore, the OSBA recommended a customer charge of $13.25 per month for GLP-1 that was consistent with the Company's customer cost analysis.

In addition to instituting a customer charge for GLP-1, Citizens' proposed increasing the monthly customer charge for GLP-3 from $50.22 to $150.00. However, Citizens' provided information to reflect that it incurs direct customer costs of only $48.20 per month to serve GLP-3 customers. Therefore, the OSBA recommended no increase in the current customer charge of $50.22, in that the current customer charge was already above cost.

The settlement set the customer charges for GLP-1 and GLP-3 at $13.25 and $50.22, respectively, which are the amounts recommended by the OSBA.

Bucknell University opposed the settlement. Of particular concern to Bucknell was the Company's proposal (adopted by the settlement) regarding how to recover distribution revenues from customers in the GLP-3 class. In that regard, Bucknell proposed an alternative that would have shifted costs from the University to the small business customers in the GLP-3 class. The OSBA objected to Bucknell's proposal because it was made after the hearing, thereby depriving the OSBA of the opportunity to present countervailing testimony.

The administrative law judge recommended approval of the settlement and rejection of Bucknell's proposal. By Order entered January 13, 2011, the Commission agreed with the administrative law judge.

Duquesne Light Company
Distribution Rate Increase
Docket No. R-2010-2179522

On July 23, 2010, Duquesne Light Company ("Duquesne" or the "Company") filed a tariff to increase distribution rates by $87.3 million per year. The increase was intended to produce an 11.25% rate of return on equity ("ROE").

On August 12, 2010, the OSBA filed a complaint against the proposed increase. Subsequently, the OSBA, and other parties, filed direct, rebuttal, and surrebuttal testimony. Thereafter, the parties negotiated a settlement.

The following are the principal reasons the OSBA signed the settlement:

First, in the settlement, Duquesne agreed to a revenue increase of $45.7 million per year rather than the $87.3 million per year the Company originally requested. The smaller rate increase is consistent with the OSBA's argument that an 11.25% ROE would produce an excessive rate increase.

Second, the settlement adopted Duquesne's proposal to split Rate GS/GM, *i.e.*, the class which includes most small business customers, into three rate schedules.

Specifically, Rate GS would be available to non-demand metered general service customers. Rate GM (< 25 kW) would be available to demand metered general service customers with monthly demands less than 25 kilowatts. Rate GM (≥ 25 kW) would be available to demand metered general service customers with monthly demands greater than or equal to 25 kilowatts. In testimony, the OSBA supported the Company's proposed split of GS/GM because it would reduce intra-class subsidization.

Third, the settlement adopted a revenue allocation which would move classes closer to cost of service than originally proposed by Duquesne. Duquesne's initial proposal would have resulted in some classes receiving distribution increases which equated to 1.75 times the requested system average increase. In response, the OSBA proposed to mitigate rate shock by limiting the rate increase for each class to 1.5 times the system average increase.

In contrast to the Company's original proposal and the OSBA's counter-proposal, the OCA proposed an alternative allocation of the distribution rate increase which would have shifted significantly more of the rate increase to small business customers.

The settlement would result in an increase which is virtually the same as the OSBA recommended for the GS, GM <25 kW, and GMH classes. For GM≥25 kW, the settlement would result in an increase of 9%, which is a compromise between the positions of the OSBA and Duquesne and which would move GM≥25 kW closer to cost of service than proposed by the Company. In sum, the settlement should save small business customers almost $3.7 million per year in comparison to the amount they would have paid under the OCA's proposal.

By Order entered February 24, 2011, the Commission approved the settlement.

Metropolitan Edison Company
and Pennsylvania Electric Company
Transmission Rate Increase
Docket Nos. M-2008-2036197 and M-2008-2036188

On April 14, 2008, Met-Ed filed Supplement No. 5 and Supplement No. 6 to Tariff Electric – Pa. P.U.C. No. 50 with the Commission. The two Met-Ed Supplements were filed in the alternative to recover an alleged under-recovery through the Transmission Service Charge ("TSC") in the amount of $144.48 million.

Also on April 14, 2008, Penelec filed Supplement No. 5 to Tariff Electric – Pa. P.U.C. No. 79 with the Commission. The Penelec Supplement was filed to recover an alleged under-recovery through the TSC in the amount of $3.5 million.

The OSBA filed a complaint in both proceedings. Several other parties also filed complaints or interventions.

The Commission approved Penelec's Supplement No. 5, subject to adjudication of the filed complaints. In the Met-Ed case, the Commission entered an Order adopting Supplement No. 6; instituting an investigation of the proposed rates; and reserving the right to order refunds if the investigation concluded that any revenues collected under Supplement No. 6 were unjust, unreasonable, or otherwise contrary to law.

The issues raised by the OSBA are that (1) the Companies are not entitled to recover interest on marginal losses and other transmission costs; and (2) the Companies should have re-adjusted their transmission rates at the conclusion of their 2006-2007 rate case to make up for the fact that their request for increasing the generation rates in that case was denied.

On July 24, 2009, the Commission issued the administrative law judge's Recommended Decision, which rejected all of the objections to the Companies' filings. However, the OSBA and several other parties filed Exceptions to the Recommended Decision.

By Order entered March 3, 2010, the Commission reversed the ALJ and denied the Companies the right to recover marginal losses. However, the Commission adopted the ALJ's recommendation to permit recovery of interest related to the re-adjustment of transmission rates at the conclusion of the 2006-2007 rate case.

Both the Companies and the OSBA appealed. On June 14, 2011, the Commonwealth Court issued a decision on the contested issues.

The Court agreed with the OSBA that the Commission erred by failing to articulate reasons for rejecting the OSBA's exception regarding interest related to the Companies' belated readjustment of transmission rates following their 2006-2007 rate case. As a result, the Court remanded to the Commission for an appropriate adjudication of the OSBA's exception.

In addition, the Court affirmed the Commission's decision that the Companies should not be allowed to recover marginal losses. As a result, the OSBA's argument that the Companies should be denied interest on the recovery is moot.

As the time of this writing, the Commission has not taken further action in this proceeding.

PPL Electric Utilities
Distribution Rate Increase
Docket No. R-2010-2161694

On March 31, 2010, PPL Electric Utilities Corporation ("PPL" or "Company") submitted a filing to the Commission that proposed to increase the company's distribution rates by $114.675 million per year. This was the third of three rate filings by PPL, wherein the company had promised to bring its customer classes to cost of service in response to the decision of the Commonwealth Court in *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010 (Pa. Cmwlth. 2006). PPL did not abide by that promise.

The OSBA filed a complaint against the proposed increase on April 29, 2010. Thereafter, the OSBA served direct, rebuttal, and surrebuttal testimony.

A settlement was reached among the parties whereby the Company would be allowed to increase its distribution rates by $77.5 million per year. No settlement was reached on the issues involving the allocation of that increase. Consequently, the OSBA filed a main brief and a reply brief on the issue of revenue allocation.

The OSBA asserted that either of the Company's two cost of service studies ("COSSs") was acceptable; but the OSBA criticized the Company's decision to propose zero rate increases, rather than the rate cuts justified by the COSSs, for the overpaying Small C&I customer classes, *i.e.*, GS-1, GS-3, and GH. To move these classes to at or near cost of service, as PPL had previously promised, the OSBA proposed to provide rate cuts through the "first dollar relief" methodology. Under first dollar relief, the overpaying classes receive rate relief before the underpaying classes, when a utility is awarded a smaller rate increase than originally requested.

In contrast to PPL's proposal for zero rate increases and the OSBA's proposal for rate cuts, the OCA proposed no rate increase for the GS-1 class but proposed significant increases for the GS-3 and GH classes. The OCA based its proposals on its own alternative COSS. The OSBA responded that the OCA's COSS was inconsistent with Commission precedent and was methodologically unsound.

The ALJ's RD was issued on October 15, 2010. The ALJ recommended the adoption of the Company's newer COSS (rather than the older PPL COSS, which relied more closely on the methodology used in previous cases). The ALJ also recommended rejection of the OCA's COSS. However, the ALJ concluded that the OSBA's "first dollar relief" proposal violated ratemaking principles, and should be rejected. Therefore, the ALJ agreed with PPL that the GS-1, GS-3, and GH classes should simply receive no rate increase, thereby moving those classes somewhat closer to cost of service (but not as close as proposed by the OSBA).

The OSBA filed exceptions and reply exceptions to the ALJ's RD.

The Commission entered its Order on December 21, 2010. The Commission upheld the ALJ's recommendation to adopt the Company's newer COSS and reject the OCA's COSS. The Commission did not agree with the ALJ's conclusion that "first dollar relief" violated ratemaking principles, but the Commission did conclude that such relief was not appropriate in this proceeding.

Although the OSBA did not succeed in winning rate cuts, the Commission's rejection of the OCA's proposal will save the GS-3 and GH classes about $11.9 million per year.

On April 27, 2011, the Commission granted the industrial intervenors' Petition for Reconsideration of a possible special rate for an industrial customer and remanded the matter to the ALJ. The OSBA is participating in the remand proceeding to make sure that non-industrial customers are not required to finance that special rate.

A second prehearing conference was held before the ALJ on May 16, 2011. The OSBA submitted direct, rebuttal, and surrebuttal testimony in the remand proceeding.

On September 16, 2011, an evidentiary hearing was held before the ALJ. The OBSA submitted a main brief and a reply brief in the remand proceeding.

On January 27, 2012, the ALJ's Recommended Decision was issued.

At the time of this writing, parties are preparing reply exceptions to the Recommended Decision.

Wellsboro Electric Company
Distribution Rate Increase
Docket No. R-2010-2172662

On June 2, 2010, Wellsboro Electric Company ("Wellsboro" or the "Company") filed a proposed tariff to increase the Company's total electric distribution revenues by $872,107 per year, *i.e.*, by 23.1%. The Company's proposed rate increase would have produced an 11.75% overall rate of return on equity ("ROE").

On June 10, 2010, the OSBA filed a Complaint against the proposed increase. Subsequently, the OSBA filed direct, rebuttal, and surrebuttal testimony. After the filing of testimony, the parties negotiated a settlement of all issues.

The following provisions were of particular significance to the OSBA in concluding that the settlement was in the best interests of small business customers:

First, Wellsboro agreed to reduce the rate increase from $870,107 per year to $700,000 per year. This provision of the settlement was consistent with the OSBA's argument that the Company's requested ROE was excessive.

Second, Wellsboro proposed a revenue allocation that purportedly moved all major rate classes closer to cost of service as measured by the Company's cost of service study ("COSS"). However, the OSBA took the position that while the Company's proposal was reasonable at the full requested revenue requirement level, the rates of return for certain small business classes, *i.e.*, the CS and IS classes, and certain lighting classes, *i.e.*, the MSL and POL classes, would remain considerably above the system average. To rectify this problem, the OSBA recommended that these four classes (CS, IS, MSL, and POL) be granted first dollar relief ("FDR") in the event that the Company was awarded a smaller rate increase than requested.

In contrast, the OCA performed its own COSS and proposed a new revenue allocation on the basis of that COSS. Under the OCA's proposal, the IS, MSL and POL classes would have provided rates of return significantly in excess of the system average (as measured by the OCA's COSS) even if the rate increase were reduced.

The settlement revenue allocation was a compromise that fell between the revenue allocation proposals of the OSBA and the OCA. As a result of the compromise, the IS, CS, MSL, and POL classes either received a distribution rate increase well below the system average increase of 19.04% or received no increase at all. Specifically, CS received a 9.67% increase, IS received a 5.44% increase, MSL received no increase, and POL received no increase. As a result, small business customers will save more than $85,000 per year in comparison to the amount they would have had to pay under the OCA's proposal.

Third, Wellsboro proposed an increase in the monthly customer charge for the NRS class of $12.00. Wellsboro concluded that $12.00 was also the appropriate charge for the NRH class. However, the OSBA recommended a monthly customer charge of $10.27 for NRS and NRH because customer charges of that amount were consistent with the Company's cost analysis.

Additionally, Wellsboro proposed to implement a monthly customer charge of $20.00 for rate CS. Wellsboro provided information to indicate that it incurs direct customer costs of $28.02 per month to serve CS customers. Consistent with Wellsboro's cost analysis, the OSBA recommended a monthly customer charge of $28.00 for CS.

Wellsboro also proposed to implement a monthly customer charge of $325.00 for Rate IS customers. However, Wellsboro provided information to indicate that it incurs direct customer costs of only $42.90 per month to serve IS customers. Therefore, the OSBA proposed a customer charge based on cost of service.

The settlement set the customer charges for NRS and NRH at $10.00, CS at $28.00, and IS at $42.90. Those charges are consistent with the amounts recommended by the OSBA.

The administrative law judge recommended approval of the settlement. By Order entered January 13, 2011, the Commission approved the settlement.

West Penn Power Company
Transmission Rate Increase
Docket No. P-2010-2158084

On February 9, 2010, West Penn Power Company ("West Penn" or the "Company") filed a petition seeking to begin recovering transmission charges through a reconcilable Transmission Service Charge ("TSC").

On February 25, 2010, the OSBA intervened in the proceeding. Subsequently, the OSBA and the other intervening parties filed direct testimony. The OSBA was generally supportive of West Penn's proposal for a reconcilable TSC. However, the OSBA opposed the Company's request to reconcile its transmission revenues and costs for the period of February 9, 2010, through January 1, 2011. In effect, the Company's proposal amounted to retroactive, single-issue ratemaking.

Prior to the filing of rebuttal testimony, the parties reached a settlement. Under the settlement, West Penn will be permitted to implement the TSC. However, consistent with the opposition of the OSBA and several other parties, West Penn will not be permitted to reconcile costs and revenues for the period between February 9, 2010, and January 1, 2011.

By Order entered February 11, 2011, the Commission approved the settlement.

2. <u>Conservation</u>

Mandatory Conservation Plans
Major Electric Distribution Companies

Governor Edward Rendell signed Act 129 of 2008 ("the Act" or "Act 129") into law on October 15, 2008. The Act required each EDC with at least 100,000 customers to adopt a plan, approved by the Commission, to reduce electric consumption by at least 1% of the EDC's expected consumption for June 1, 2009, through May 31, 2010, adjusted for weather and extraordinary loads. This 1% reduction is to be accomplished by May 31, 2011. By May 31, 2013, the total annual weather-normalized consumption is to be reduced by a minimum of 3%. Also, by May 31, 2013, peak demand is to be reduced by a minimum of 4.5% of the EDC's annual system peak demand in the 100 hours of highest demand, measured against the EDC's peak demand during the period of June 1, 2007, through May 31, 2008. By November 30, 2013, the Commission is to assess the cost-effectiveness of the program and set additional incremental reductions in electric consumption if the benefits of the program exceed its costs.

Act 129 required the Commission to establish an Energy Efficiency and Conservation Program ("EE&C Program") in order to set parameters for the individual EDC plans. The Commission sought comments from the EDCs and other interested parties on the content of the Commission's EE&C Program. The OSBA was among the parties which submitted comments. The OSBA also participated in a special *en banc* hearing on alternative energy, energy conservation and efficiency, and demand side response.

The Commission subsequently circulated a draft staff proposal of its EE&C Program and held an EE&C Program stakeholder meeting, in which the OSBA participated. The OSBA also submitted reply comments on the Commission's draft staff proposal. After considering the parties' input, the Commission entered an Implementation Order (at Docket No. M-2008-2069887) on January 15, 2009, that established its EE&C Program.

On July 1, 2009, each of the following EDCs filed an energy efficiency and conservation plan ("EE&C plan") with the Commission for review and approval: West Penn Power Company, at Docket No. M-2009-2093218; Duquesne Light Company, at Docket No. M-2009-2093217; PPL Electric Utilities Corporation, at Docket No. M-2009-2093216; PECO Energy Company, at Docket No. M-2009-2093215; and Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company, consolidated at Docket No. M-2009-2092222. The OSBA intervened in each EDC's proceeding, filed testimony, and submitted briefs.

Each EDC proposed its own mix of EE&C programs and proposed its own customer groupings for delivery of those programs and the recovery of the related costs. Although the OSBA evaluated each EE&C plan and commented on some of the unique aspects of the plans, the OSBA focused its attention on key policy and procedural issues applicable to the plans across-the-board.

Of particular significance to the OSBA, Act 129 explicitly requires that the costs for approved EE&C measures be financed by the same customer class that will receive the direct energy and conservation benefits from those measures. The effect of this language is to prohibit inter-class subsidization.

After an initial evaluation, the OSBA concluded that each EE&C plan was reasonable enough to begin implementation. Given the abbreviated time frame for reviewing the filings and also the lack of data (because the programs are new and untested), the OSBA pointed out that an assessment of the worthiness of the various proposed EE&C programs prior to implementation would be speculative.

Nevertheless, the OSBA did make several recommendations. First, the OSBA proposed that each EE&C plan be modified to assure a full vetting of the plan as part of an annual reconciliation proceeding. The OSBA proposed that the annual vetting should include an evaluation of the cost-effectiveness of the various EE&C programs and the recovery of the costs of those programs. Although the Commission addressed the annual review process somewhat differently for each EDC, it appears that the process approved by the Commission will provide the OSBA the opportunity to recommend changes in the EE&C plans and to challenge the allocation of specific costs among the customer groupings.

Second, each EE&C plan must achieve a minimum of 10% of the plan's reductions in both overall consumption and peak demand from units of federal, state, and local government, including municipalities, school districts, institutions of higher education, and nonprofit entities ("Government/Non-Profit"). To varying degrees, the EDCs proposed to group Small Commercial and Industrial ("Small C&I") customers and Government/Non-Profit customers together for cost recovery purposes. As a result, Small C&I customers are likely to subsidize the cost to achieve the significant reductions in consumption and peak demand required from Government/Non-Profit customers. To avoid that subsidization, the OSBA proposed that each plan be modified to place Government/Non-Profit entities into a separate class for cost recovery purposes. Although the Commission rejected the OSBA's proposal, several EDCs did agree to collect the costs of municipal lighting EE&C programs solely from the lighting classes, thereby relieving Small C&I customers from having to bear those costs.

Third, several EDCs proposed to include the EE&C cost recovery mechanism as part of the distribution charge on customers' bills. In response, the OSBA pointed out that the costs associated with the EE&C programs are not distribution costs; rather, they are subsidies to a subset of customers to encourage participation in EE&C programs. The OSBA also warned that customers would likely (albeit incorrectly) view the EE&C charge as a distribution rate increase, thereby complicating future efforts to move distribution rates to cost of service. Finally, the OSBA opined that a separate charge for conservation is likely to receive a better reception from ratepayers when coupled with communication efforts from each EDC to promote its EE&C plan. Therefore, the OSBA recommended that the EE&C cost recovery mechanism be listed as a separate line item on customers' bills rather than be included within distribution rates. The Commission agreed with the OSBA that the EE&C charge should be listed separately on the bills of business customers.

On or before September 15, 2010, the EDCs made filings to facilitate the first annual Commission review of their EE&C plans. The OSBA reviewed these filings but ultimately contested only the proposal by West Penn to make major changes in the EE&C plan previously approved by the Commission.

Specifically, West Penn proposed to reduce its heavy reliance on smart meters and to add new programs and expand existing programs in order to meet the conservation reductions mandated by Act 129. The net effect of the amendments was to shift about $6 million in costs from Residential customers to Small C&I customers. The OSBA and

West Penn reached an agreement under which the EDC could implement the proposed changes, but the question of whether Small C&I customers would be charged an additional $6 million would be deferred for future litigation.

The Commission subsequently approved the West Penn amendments and the annual filings of the other EDCs.

UGI Utilities-Electric Division
Voluntary Conservation Plan
Docket No. M-2010-2210316

On November 9, 2010, UGI Utilities, Inc. – Electric Division ("UGI" or "Company") filed a Petition for Approval of its Energy Efficiency and Conservation Plan with the Commission. Because UGI Electric serves only 62,000 electric customers, the Company's Petition was a voluntary proposal rather than one mandated by Act 129 of 2008.

The OSBA filed a notice of intervention and answer in regards to the petition on November 29, 2010.

A prehearing conference was held before an ALJ on January 5, 2011. The OSBA submitted direct, rebuttal, and surrebuttal testimony in this proceeding.

An evidentiary hearing was held on May 4, 2011, before the ALJ.

The OSBA submitted a main brief and a reply brief. The OSBA argued that the Company should not be allowed to implement a revenue decoupling mechanism, *i.e.*, a mechanism to recover distribution revenue margins presumed to have been lost because of a conservation-related decline in sales. The OSBA asserted that a decoupling was a violation of Act 129, Commission policy, and would financial harm those customers not participating in any conservation measure. The OSBA also briefed issues regarding the subsidization of the proposed measured non-residential customers; the cost-effectiveness of the Company's proposed plan; and the Company's fuel switching proposal.

On July 15, 2011, the ALJ's Recommended Decision was issued. The ALJ agreed with the OSBA and other parties that the Company's proposal to implement a revenue decoupling mechanism should be denied. The Company filed exceptions to the Recommended Decision. The OSBA filed reply exceptions in response to the Company.

On October 19, 2011, the Commission entered an Order upholding the Recommended Decision and denying the Company's proposed revenue decoupling mechanism.

3. <u>Smart Meters</u>

Each electric distribution company ("EDC") with at least 100,000 customers was required to file a smart meter technology procurement and installation plan ("SMIP") with the Commission pursuant to Act 129 of 2008. After soliciting input from the EDCs and other interested parties, the Commission entered an Implementation Order (at Docket No. M-2009-2092655) to establish the parameters for the individual SMIPs.

On August 14, 2009, the following EDCs filed their SMIPs: West Penn Power Company, at Docket No. M-2009-2123951; Duquesne Light Company, at Docket No. M-2009-2123948; PPL Electric Utilities Corporation, at Docket No. M-2009-2123945; PECO Energy Company, at Docket No. M-2009-2123944; and Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company, consolidated at Docket No. M-2009-2123950. The OSBA intervened in each EDC's proceeding and filed testimony and briefs as deemed necessary. For the most part, the OSBA focused on the allocation of SMIP costs among the customer classes and the collection of those costs within the classes which include Small C&I customers.

Of particular significance to the OSBA, the Commission's Implementation Order provides that SMIP costs which benefit only one class are to be recovered solely from that class. However, costs which benefit more than one class, *i.e.*, "common costs," are to be allocated among the classes on the basis of reasonable cost of service practices.

The EDCs proposed to recover the cost of each smart meter directly from the class for which that meter is purchased and installed. This approach is consistent with the Implementation Order and also recognizes that the cost of a meter is likely to vary on the basis of the meter's size and functionality. Although there has been no dispute among the parties on the assignment of these costs directly to the classes, there has been considerable controversy over the allocation of the "common costs" among the classes.

Specifically, the EDCs proposed to allocate these common costs to the rate classes on the basis of the relative number of customers in each class. The OSBA supported the EDCs' approach, in that common costs are likely to vary on the basis of the number of customers in each class and not on the basis of the classes' relative consumption of electricity. However, the OCA opposed the EDCs' approach and argued that the common costs should be allocated on the basis of the relative energy consumption and coincident peak demand of each rate class. The OCA's proposal would have effectuated a dramatic reduction in the share of the common costs allocated to the Residential rate class and a dramatic increase in the share of the common costs allocated to the Small C&I and Large C&I rate classes.

The essence of the OCA's argument was that smart meters will reduce electricity costs for ratepayers, that the ratepayers who use more electricity will "benefit" more from these reduced costs, and that the ratepayers who "benefit" more from these reduced costs should pay a larger share of the SMIP costs than the ratepayers who "benefit" less. In making this argument, the OCA assumed that Small C&I customers are more likely to be able to reduce their electric bills through the use of smart meters than are customers in the Residential class. However, the OSBA pointed out that there is no reason to believe that restaurants and retail establishments will be able to shift their load to off-peak periods as (or more) readily than Residential customers will be able to shift their use of dishwashers, washing machines, and dryers to the evening hours or weekends. In that regard, the OSBA noted that it is unrealistic to assume that a restaurant which relies upon its lunch, Happy Hour, and dinner patrons will be able to shift its load to off-peak hours and manage to continue in business.

The OCA's proposal also assumed that the principal reason for mandating the deployment of smart meters is to save ratepayers money. However, the OSBA pointed out that smart meters are expected to result in environmental benefits which will accrue to all citizens, regardless of how much electricity they use and regardless of whether their electric bills go down—or go up—as a result of smart meters.

The Commission approved the SMIP for each of the EDCs other than West Penn. In approving those SMIPs, the Commission rejected the OCA's cost allocation proposal and adopted the position advocated by the EDCs and the OSBA. As a result, Small C&I customers will save tens of millions of dollars in comparison to the amounts they would have had to pay under the OCA's proposal. For example, PECO's Small C&I customers saved about $2.7 million in 2010 and could save about ten times that amount over the life of the Company's SMIP. Similarly, the Small C&I customers of Met-Ed, Penelec, and Penn Power could save an estimated $28 million to $34 million over the life of their SMIP.

Unlike the litigated result in the cases of the other EDCs, the cost allocation issue was resolved as part of a settlement of West Penn's SMIP proceeding. The settlement rejected the OCA's cost allocation methodology. As a result, Small C&I customers could save $20 million to $40 million over the life of the SMIP. Furthermore, the OSBA reserved the right to challenge recovery of certain costs incurred by West Penn under the Company's initial proposal to deploy smart meters on an accelerated basis.

West Penn Power Company
Dynamic Pricing
Docket Nos. P-2011-2218683 and P-2011-2224781

On December 30, 2010, West Penn Power Company ("West Penn" or "Company") filed a petition at Docket No. P-2011-2218683, seeking Commission approval to offer optional time-of-use default service generation rates ("TOU") to residential and small business customers. Subsequently, on February 3, 2011, West Penn initiated a second proceeding by filing a petition at Docket No. P-2011-2224781, seeking Commission approval of an optional Residential Critical Peak Rebate Rate Offering

("CPR") for residential customers, and a Non-Residential Critical Peak Pricing Rate Offering ("CPP") for small business customers.

The OSBA did not file direct testimony in the TOU proceeding at Docket No. P-2011-2218683 because it had no objection to West Penn's original proposal.

However, on April 8, 2011, the OSBA filed the rebuttal testimony of its witness in response to a proposal made in the direct testimony filed on behalf of the Office of Consumer Advocate ("OCA"). Specifically, the OCA proposed that shopping customers should share in the cost of the TOU even though they could not participate in the TOU program.

After filing testimony, the parties reached a settlement. Under the Settlement, the TOU for ST20 and ST30, the classes in which small commercial and industrial ("Small C&I") customers take default service, was withdrawn and, in effect, replaced by an option for those customers to choose hourly pricing.

Furthermore, the issue of a specific TOU for residential customers has been deferred until the next default service case.

Consequently, the disagreement between the OSBA and the OCA has been rendered moot with regard to Small C&I customers and has been deferred with regard to residential customers.

As part of its filing at Docket No. P-2011-2218683, the Company proposed the CPR program, which would offer rebates to residential customers for reducing their consumption during periods of highest peak demand. The Settlement adopts the CPR with some modifications. The proposed CPR will be available only to qualified residential customers that have been provided with smart meter technology, who elect to participate, and who are eligible to receive Service Type 10.

The OSBA took no position on the CPR program, in that the program will be limited to (and funded by) residential customers.

West Penn's CPP proposal would be offered only to Small C&I and Medium C&I customers who take default generation service from West Penn in Service Types ST20 and ST30.

The OSBA did not file direct testimony in the CPR/CPP proceeding at Docket No. P-2011-2224781 because it had no objection to West Penn's original proposal. However the OSBA filed rebuttal testimony in response to certain proposals made in the direct testimony of the Retail Energy Supply Association ("RESA"). Specifically, RESA proposed that shopping customers should share in the cost of the TOU even though they could not participate in the TOU program. Further, RESA argued in favor of allowing competitive electric generation suppliers ("EGS") to assume responsibility for providing dynamic pricing to default service customers.

After filing testimony, the parties reached a settlement. The Settlement provides that West Penn will not set summer CPP rates based on forward prices, as initially proposed. Instead, any month not defined as part of the "Summer Period" will be priced according to the default service pricing provisions of the controlling rate schedule. The Settlement also modifies the Scaling Factors used for the "Summer Period." While a full explanation of the changes is set forth in the Settlement, it is significant that the Scaling Factors for each service type will be applied to the appropriate default service rates and not to the forward market prices as originally proposed by West Penn. In addition, the Scaling Factors will be adjusted, as necessary, to ensure revenue neutrality when compared to the default service rates. The summer coincident peak and off-peak rates will be established from the coincident Summer Period default service rates of Service Types 20 and 30. As a result, CPP rates will be more consistent with the rates paid by regular default service ratepayers. This provision of the Settlement is consistent with the OSBA's recommendations.

The Settlement also provides that the CPP reconciliation rate, starting with the 2012 Summer Period, will be applied to current and former CPP participants. The reconciliation rate will be applied as a credit or charge, depending on whether the deferral balance is a regulatory liability or regulatory asset. Significantly, the reconciliation rate will apply to customers regardless of current shopping status, *i.e.*, customers who participate in the CPP program and then decide to shop will be subject to reconciliation for the period they were in the CPP program. The Settlement also provides that, for the period through May 31, 2013, customers who elect CPP must remain on CPP as their default service option from West Penn. Furthermore, customers who leave CPP in order to shop will be required to take CPP service if they subsequently cease shopping. As a result of these changes in the CPP as originally proposed by West Penn, there will be less opportunity for gaming. These changes are consistent with the OSBA's recommendations.

By Order entered July 1, 2011, the Commission approved the settlement.

4 Default Service

Pike County Light & Power Co.
Default Service (2011-2013)
Docket No. P-2010-2194652

On August 19, 2010, Pike County Light & Power Company ("Pike" or the "Company") filed a petition, seeking Commission approval of a plan to supply its default service customers for the period from June 1, 2011, through May 31, 2013.

The OSBA supported Pike's proposal to continue to acquire default service electricity for Pike customers through spot market purchases. The OSBA also supported Pike's proposal to continue the default service rate design that was currently in place.

However, the OSBA made two recommendations to help inform customers that Direct Energy's aggregation program is being terminated as of June 1, 2011. First, the OSBA recommended that a shopping guide be included in a letter sent to all customers prior to the termination of Direct Energy's aggregation program. Second, the OSBA recommended that customers' bills be modified to include references to electronic and physical information sources for competitive pricing, including the Pike website (which presents a history of default service prices), the Pike shopping guide, and the OCA shopping website.

After filing testimony, the parties reached a settlement. Under the settlement, Pike's current default service plan and rate design will continue through May 31, 2012. The settlement also reflects the OSBA's recommendations regarding how Pike's customers should be informed that Direct Energy's aggregation program is being terminated as of June 1, 2011.

By Order entered February 25, 2011, the Commission approved the settlement.

**Citizens' Electric Company of Lewisburg, PA
and Wellsboro Electric Company
Default Service (2010-2013)
Docket Nos. P-2009-2110780 and P-2009-2110798**

On May 18, 2007, Citizens' Electric Company of Lewisburg, PA ("Citizens'"), and Wellsboro Electric Company ("Wellsboro") (collectively, "the Companies") filed for approval of a plan (at Docket Nos. P-00072306 and P-00072307) to provide default service beginning on January 1, 2008.

Thereafter, the Companies hired Aces Power Management LLC ("APM"), a wholesale trading and risk management firm, to assist in the development of a procurement methodology. With the guidance of APM, Citizens' and Wellsboro initially proposed a procurement plan ("the Scheduled Procurement Plan") that consisted of a 25 MW 7x24 block product and a 25 MW 5x16 block product to be purchased each quarter. The remainder of the Companies' default service requirements were to be purchased through the PJM spot market.

However, at the hearing, the Companies presented rebuttal testimony which significantly modified their original position in the case and proposed a new procurement plan ("the Stratified Procurement Plan"). Under the Stratified Procurement Plan approach, the Companies proposed to purchase power via an annual 7x24 block product for approximately 20 to 25 MW of load, with the remainder of the load met through monthly contracts of mostly 5 MW increments plus spot market purchases.

The OSBA supported the Scheduled Procurement Plan and opposed the Stratified Procurement Plan. In the OSBA's view, the Stratified Procurement Plan (which is an "actively" managed portfolio), gave the Companies too much discretion as to when to buy power and how much to buy in each purchase. In theory, this discretion would enable the Companies to "time the market" in order to get lower prices than under the more rigid Scheduled Procurement Plan (which is a "passively" managed portfolio). However, the Stratified Procurement Plan did not explicitly subject the Companies' decisions to a prudence review, whereby recovery of the purchase price of any procurements could be denied if the Companies made unsound choices. Without a prudence review, the risk of mistakes by the Companies would fall entirely on the ratepayers.

On October 3, 2007, the Commission entered an Opinion and Order, which approved the Companies' Stratified Procurement Plan for the period of January 1, 2008, through May 31, 2010. Rather than impose a requirement for prudence review, the Commission ordered that the Companies, the Commission's Office of Trial Staff ("OTS"), the OCA, and the OSBA initiate a collaborative process to develop portfolio performance benchmarks and reporting requirements for those benchmarks.

In accordance with the Commission's directive, the Companies, the OSBA, the OCA, and the OTS attempted to develop consensus performance benchmarks. The parties agreed that the following three performance benchmarks should be used:

1) The total power, transaction, and administrative costs incurred under the Companies' Stratified Procurement Plan will be compared to the total power, transaction, and administrative costs that would have been incurred if all of the power had been purchased in the spot market.

2) The total power, transaction, and administrative costs incurred under the Companies' Stratified Procurement Plan will be compared to the total power, transaction, and administrative costs that would have been incurred under the Companies' Scheduled Procurement Plan, *i.e.*, the purchase each quarter of a 25 MW 7x24 block and a 25 MW 5x16 block and the purchase of the remainder of the Companies' default service requirements on the PJM spot market.

3) The total power, transaction, and administrative costs incurred under the Companies' Stratified Procurement Plan will be compared to total power, transaction, and administrative prices that could have been obtained through an RFP for long-term, full-requirements contracts.

However, the parties could not reach a consensus on how the third benchmark should be constructed in order to obtain a valid proxy for the costs associated with long-term, full-requirements contracts to serve the Companies' default service customers. The parties also could not reach a consensus on the timing and frequency of the Companies' submission of the benchmark reports.

The Companies, the OCA, and the OSBA submitted comments to the Commission regarding the two benchmark issues on which they had been unable to agree. In an Opinion and Order entered on March 28, 2008, the Commission decided that the third benchmark should be constructed using the New Jersey auction but that the Companies should not be required to devote substantial resources to rendering the New Jersey "results into a directly 'equivalent' Citizens/Wellsboro price." The Commission also ordered that Citizens' and Wellsboro should provide benchmark reports annually and not quarterly (as the OSBA suggested).

Although the first annual benchmark report was due on April 1, 2009, the Companies did not file it until May 14, 2009. The Companies' benchmark report provided the results for only calendar year 2008. For 2008, the Companies' benchmark report showed that the Stratified Procurement Plan produced the lowest average procurement cost per MWh, for both Citizens' and Wellsboro, compared to spot market purchases, the Scheduled Procurement Plan, and the full-requirements contract.

On May 29, 2009, the Companies filed their proposed default service plan (at Docket Nos. P-2009-2110780 and P-2009-2110798) for the period of June 1, 2010, through May 31, 2013. Relying on the results shown in the benchmark report, the Companies requested approval to continue using the Stratified Procurement Plan, with several modifications which would give them even greater discretion. Specifically, the Companies requested permission to utilize certain financial products, *e.g.*, call options and swaps, to acquire default service supplies. In addition, the Companies requested permission to employ an abbreviated (30-day) review process for the purpose of obtaining Commission approval to enter into transactions for multiple year products, including the possibility of products to be delivered years beyond the end of the default service period.

During the subsequent discovery process, the OSBA identified several flaws in the benchmark report. First, the Companies failed to update the benchmark report to include the data available for the first and second quarters of 2009. Second, the Stratified Procurement Plan results included by the Companies in the benchmark report did not take into account the prices of the contracts that Citizens' and Wellsboro had entered with Lehman Brothers ("Lehman") for 2008 and 2009.

With regard to the second flaw in the benchmark report, the Companies had entered into two separate contracts with Lehman for 7x24 products. The first contract was for the calendar year of 2008. However, Lehman failed to deliver energy to both

Citizens' and Wellsboro for the time period of September 15, 2008, through December 31, 2008. The second contract was a twelve-month contract executed on June 26, 2008, for energy to be delivered in 2009. Lehman also failed to deliver under that contract. As a result, the Companies had to buy energy from other suppliers to replace the 7x24 products that Lehman failed to deliver.

Because Lehman's failure to deliver energy to Citizens' and Wellsboro occurred during a period of energy price decline, the Companies were able to purchase replacement energy at prices which actually were below the prices under the Lehman contracts. This outcome was fortunate for Citizens' and Wellsboro's ratepayers, but it did not provide the basis for a fair assessment of the success or failure of the Stratified Procurement Plan. Therefore, the OSBA requested that the Companies supplement their benchmark report by providing the information necessary to run the benchmark analysis to include the first and second quarters of 2009 and to show what would have been the results under the Stratified Procurement Plan if Lehman had delivered under its two contracts.

The revised benchmark results showed that if Lehman had performed, the Stratified Procurement Plan would have produced a higher average procurement cost than the Scheduled Procurement Plan. Nevertheless, despite the revised benchmark results, the Companies continued to advocate for the continuation of the Stratified Procurement Plan (with APM as the portfolio manager) from June 1, 2010, through June 1, 2013, and for the two modifications.

The OSBA opposed the continuation of the Stratified Procurement Plan and opposed the two modifications proposed by the Companies. In view of the revised benchmark results, the OSBA recommended that the Companies use the Scheduled Procurement Plan, rather than the Stratified Procurement Plan, for the period from June 1, 2010, through May 31, 2013. Furthermore, the OSBA proposed that the Companies explore the possibility of purchasing default service electricity for its small business customers in conjunction with larger, neighboring electric distribution companies for service on and after June 1, 2013.

By Order entered February 26, 2010, the Commission approved the Companies' request to continue using the Stratified Procurement Plan for the period of June 1, 2010, through May 31, 2013. However, the Commission denied the Companies' requested modification for an abbreviated approval process regarding the purchase of multiple-year products. The Commission also limited the Companies' requested modification to add financially-settled products to its portfolio. Specifically, the Commission allowed the Companies to use *cleared* financial products obtained in the New York Mercantile Exchange ("NYMEX") and Intercontinental Exchange ("ICE") but denied the Companies the right to use non-cleared products. Even though the Commission limited the Companies' use of financial products to cleared products, the Commission stated that the Companies were not precluded from seeking to modify the default service plan in the future to add non-cleared financial products as long as the Companies provided a clearer explanation of the parameters and restrictions they propose to apply to transactions for financial products.

The Commission further directed the Companies to continue the annual benchmark reports. However, the Commission directed the parties to consider revising the third benchmark to eliminate the analysis of EDCs in New Jersey and include PPL Electric Utilities Corporation ("PPL") and Pennsylvania Electric Company ("Penelec"). The parties were directed to file a status report on their discussions of these possible changes in the benchmark analysis.

The Companies subsequently sent a status report of the benchmark discussions to the Commission but indicated that the parties had not resolved the issue of possible changes to the third benchmark analysis.

On September 2, 2010, the Companies filed a Petition for Expedited Approval to Amend Joint Default Service Program. Specifically, the Companies requested that the default service plan for the period of June 1, 2010, through May 31, 2013, be amended to allow the use of non-cleared financial products.

The OSBA had several concerns with the Companies' proposal. First, rather than proposing a gradual approach to including non-cleared financial products in their portfolio, the Companies requested approval to use non-cleared financial products for up to 100% of their 7x24 base load and up to 50% of their 5x16 intermediate load. Second, despite touting the benefits of using non-cleared financial products, the Companies provided no estimate of the magnitude of the anticipated savings. Third, the Companies proposed no change in the third benchmark.

Ultimately, the parties reached a settlement. The settlement mitigated the OSBA's concerns because it lowered the percentage of non-cleared financial swaps that would be used to meet the Companies' base load (7x24) to 60%. Moreover, the Companies agreed in the settlement not to change the percentages and types of authorized non-cleared financial products set forth in the settlement for the duration of the current default service plan, *i.e.*, through May 31, 2013, thereby giving the Commission the opportunity to evaluate what, if any, savings non-cleared financial products can provide in customers' default service rates. Furthermore, the third benchmark was revised by eliminating the analysis of EDCs in New Jersey, and including PPL and Penelec.

By Order entered February 11, 2011, the Commission approved the settlement.

PPL Electric Utilities
Reconciliation and Recovery of Default Service Costs
Docket Nos. M-2010-2213754, M-2011-2243137, P-2011-2256365

A. Transmission Service Charge ("TSC") Reconciliation

On December 10, 2010, PPL Electric Utilities Corporation's ("PPL Electric" or the "Company") submitted its final 2010 Transmission Service Charge ("TSC") reconciliation report. On February 8, 2010, a Recommended Decision approved the unchallenged reconciliation.

On March 22, 2011, PPL Electric informed the Commission that there was an error in the December 2010 TSC reconciliation report. Specifically, PPL Electric had used 2008 demand data rather than 2009 demand data to reconcile the 2010 TSC demand charges. On April 29, 2010, PPL Electric filed its TSC reconciliation of actual costs and revenues for December 1, 2010 through March, 31, 2011, which reflected a correction of the demand miscalculation.

However, Commission staff review of this matter raised a policy issue with regard to the manner in which PPL Electric allocates demand for TSC reconciliation purposes. PPL Electric allocated its 2010 actual TSC demand charges based on allocators calculated using *historical* 2009 TSC demand usage. Staff review indicated that using 2009 demand allocators may have resulted in a misalignment between certain costs and cost causers and may have created inter-class subsidies.

Therefore, the Commission entered an order on May 19, 2011 ("TSC Order"), which deferred the Recommended Decision and raised the possibility of a change in the allocation of TSC costs among rate classes. The TSC Order also invited comments from the statutory advocates on this issue. The OSBA submitted comments in response to that invitation on June 20, 2011, because a change in allocation could adversely affect the Company's small business customers.[3]

At the time of this writing, the matter is pending before the Commission.

B. Generation Service Charge ("GSC") Reconciliation

On May 20, 2011, PPL Electric filed its Calculation of Generation Supply Charge-1 for the application period June 1, 2011, through August 31, 2011 ("June GSC-1"). The June GSC-1 proposed to recoup an $18.6 million undercollection (for the period December 1, 2009, through May 31, 2011) over three months by increasing the GSC-1 for small commercial and industrial customers from 9.276 cents per kWh to 12.171 cents

[3] By Order entered May 19, 2011, at Docket No. M-2011-2239714, the Commission initiated a generic investigation into how an electric distribution company ("EDC") should reconcile past period over and under collections in its TSC. The OSBA also submitted comments in that proceeding.

per kWh (including Gross Receipts Tax or "GRT"). Of the 12.171 cents per kWh, 4.15 cents per kWh was related to PPL Electric's reported undercollection of costs in previous periods.

On May 31, 2011, the OSBA filed a Complaint alleging this rate to be unjust, unreasonable, unduly discriminatory, and otherwise contrary to law, particularly as it pertained to small business customers.[4] Subsequently, the OSBA filed direct and surrebuttal testimony.

The OSBA's argument is that the GSC-1 charged was unjust and unreasonable because the reported undercollection being recouped by PPL Electric through the GSC-1 was not a true undercollection. Rather, it was the result of (1) PPL Electric's flawed reconciliation accounting method that reconciles incurred costs and billed revenues rather than earned revenues and (2) PPL Electric's apparent under-reporting of revenues. The OSBA argued that the Commission should find PPL Electric's reconciliation accounting mismatch to be unreasonable and make refunds to small business customers accordingly. The OSBA also requested a detailed audit by the Commission's Bureau of Audits, focusing explicitly on the issues identified by the OSBA in this proceeding. Specifically, that the reported undercollection that resulted from PPL Electric's reconciliation accounting method does not explain the entire reported 2010 undercollection. A review of PPL Electric's revenues for 2010 revealed that an apparent under-reporting of revenues may account for the unexplained shortfall. This conclusion is based on the fact that the per-kWh revenues reported by PPL Electric are not consistent with the tariff rates charged. Because only the Company is in a position to explain this variance, which PPL Electric has not adequately done, the OSBA argued that an audit is necessary to evaluate PPL Electric's default service cost and revenue records for 2010 properly.

A hearing was held on October 5, 2011 followed by submission of Main Briefs and Reply Briefs. A Recommended Decision has not been issued as of the date hereof.

At the time of this writing, the matter is pending before the Commission.

C. Proposed Reconciliation Rider and Competitive Transition Rider

On August 5, 2011, PPL Electric filed a petition seeking authorization to implement a Reconciliation Rider ("RR") and Competitive Transition Rider ("CTR") related to the transmission service and generation supply service that the Company provides to its default service customers. Pursuant to the RR, the Company would refund over-collections to, and recover under-collections from, customers who were default service customers when the over-collection or under-collection occurred. The proposed

[4] The OSBA has also filed complaints against the GSC-1 rate for the application period September 1, 2011 through November 30, 2011 at Docket No. M-2011-2258733 and the GSC-1 rate for the application period December 1, 2011 through February 29, 2012 at Docket No. M-2011-2274191. In the interest of judicial economy, these complaints been held in abeyance pending the outcome of the already litigated proceeding because they deal with similar issues.

CTR would be a temporary, non-bypassable reconcilable rider that would refund, or recover, the balance of historic over-collections or under-collections in existence on the effective date of the RR to all distribution customers, shopping and non-shopping.

The OSBA generally supported the Company's proposal to implement the RR, but with certain modifications. Specifically, that: (1) the RR should be reconciled on a rolling annual basis, as opposed to the fixed annual basis initially proposed by the Company; (2) new customers should not be subject to the RR for 12 months; and (3) interest charges on under-collections and credits on over-collections should be set at or near the Company's short-term borrowing and earnings rates. PPL Electric subsequently agreed with the first and second of these recommendations, but not the third.

The OSBA supported the implementation of the migration rider aspect of the RR for reasons of cost causation and equity. PPL Electric's current reconciliation mechanisms allow customers to avoid reconciliation charges for undercollections that occurred while they were default service customers by choosing to shop. Similarly, the current reconciliation mechanisms allow customers to take advantage of reconciliation refunds for over-collections that occurred while they were shopping customers by returning to default service. The RR, in contrast, more closely assigns charges and refunds to customers who took service when the over/under-collection occurred. Thus, the RR better aligns the recovery/refund of any variance with the customers who caused it.

The OSBA argued that PPL Electric's current reconciliation mechanisms distort retail competition because they include in the Price To Compare ("PTC") reconciliation charges/refunds that are unrelated to current costs to provide default service, but rather are charges/refunds for historical variances in default service costs and revenues.

The OSBA further supported the RR as a way to address the instability of PPL Electric's default service rates. PPL has experienced substantial problems with reconciliation resulting in unstable rates. The RR should reduce volatility by spreading variances over a longer time period.

In contrast, the OSBA opposed the Company's proposal to implement the CTR because it is unnecessary and inequitable. The Company presented no evidence that there will be a substantial variance on the effective date of the RR, or that any such variance cannot be timely recovered through the RR. Nor did the Company present any evidence that *all* shopping customers will have contributed to the over- or under-collection that exists on the effective date of the RR. The OSBA argued that imposing the CTR on all shopping customers without any clear showing that they contributed to the over- or under-collection is inconsistent with the regulatory principle of cost causation and is inequitable.

The OSBA submitted direct, rebuttal and Surrebuttal testimony. An evidentiary hearing was held on December 5, 2011 followed by submission of Main Brief and Reply Briefs. A Recommended Decision has not been issued as of the date hereof.

At the time of this writing, the matter is pending before the Commission.

5. Mergers and Acquisitions

West Penn Power Company
Merger
Docket Nos. A-2010-2176520 and A-2010-2176731

On May 14, 2010, West Penn Power Company d/b/a Allegheny Power ("West Penn"), Trans-Allegheny Interstate Line Company ("TrAILCo"), and FirstEnergy Corporation ("FirstEnergy") ("Joint Applicants") filed the Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company, and FirstEnergy Corporation ("Joint Application") seeking approval to merge West Penn and TrAILCo's parent company, Allegheny Energy, Inc. ("Allegheny Energy"), with FirstEnergy.

On June 14, 2010, the OSBA filed a protest against the merger. As stated in the protest, the OSBA's principal concern is the merger's negative impact on default service rates.

Following the filing of testimony, a settlement was reached by some of the parties. However, the OSBA is not a settling party.

The OSBA's major objection to the settlement is that it does not restrict FirstEnergy's use of Allegheny Energy's low-cost generation to expand the share of the Pennsylvania retail market dominated by First Energy's EGS affiliate, FirstEnergy Solutions ("FES"). A key element of that retail market expansion is municipal aggregation. Under municipal aggregation, a residential or small business customer in a participating municipality will receive service from FES unless the customer affirmatively chooses to remain on default service or to purchase service from a different EGS. Despite the fact that legislation authorizing municipal aggregation has not yet been enacted, FES has already solicited contracts with municipalities governed by the Home Rule Charter and Optional Plans Law.

As pursued by FirstEnergy, municipal aggregation will violate the Public Utility Code because residential and small business customers in the participating municipalities will automatically receive aggregation service, rather than default service, if they do not affirmatively opt out of the aggregation.

Furthermore, FirstEnergy's municipal aggregation strategy will increase the risk faced by suppliers of full-requirements contracts, thereby resulting in higher default service rates for non-shopping customers during the January 1, 2011, through May 31, 2013, default service period.

Finally, because of its advantage as the incumbent utility and its ownership of local generation capacity, FirstEnergy's municipal aggregation strategy will make it harder for other EGSs to compete with FES.

Although the settlement will produce some affirmative benefits, those benefits will be far outweighed by the harm FirstEnergy's municipal aggregation strategy will do to default service customers. Therefore, the OSBA proposed that the Commission reject the proposed transfer of control of Allegheny Energy to FirstEnergy, unless the Commission imposes the following additional conditions:

a. First Energy Corporation and its affiliates shall not engage in municipal aggregation in the Met-Ed, Penelec, Penn Power, and West Penn service territories prior to the enactment and implementation of authorizing legislation or June 1, 2013, whichever is later; and

b. FirstEnergy shall administratively locate the generating assets of FirstEnergy Corporation and Allegheny Energy, Inc., in separate subsidiaries that shall not coordinate regarding whether to bid in a particular default service procurement and regarding what price to bid.

By Order entered March 8, 2011, the Commission approved the merger and rejected the conditions proposed by the OSBA. In the Commission's view, the conditions were premature because it was unclear what the future standards for municipal aggregation would be.

RESA/Dominion Retail/FirstEnergy Solutions
Municipal Aggregation
Docket Nos. P-2010-2207062, P-2010-2207953, and P-2010-2209253

FirstEnergy's affiliated EGS, FirstEnergy Solutions ("FES"), has solicited contracts with the Borough of Edinboro ("Edinboro"), the City of Warren ("Warren"), the City of Farrell ("Farrell"), and the City of Meadville ("Meadville") for municipal aggregation. Under municipal aggregation, a residential or small business customer in a participating municipality will receive service from FES unless the customer affirmatively chooses to remain on default service or to purchase service from a different EGS.

In response to FES's activities, the Retail Energy Supply Association ("RESA") and Dominion Retail, Inc. ("Dominion") filed petitions with the Commission.

By its petition, RESA requested that the Commission immediately issue a Secretarial Letter directing any EGS engaging in opt-out municipal aggregation to stay any such activities and not execute any contract. RESA also requested that the Commission initiate an investigation into the municipal aggregation activities of EGSs in Pennsylvania. RESA further requested that, upon completion of the investigation, the Commission issue an Order declaring the following: (1) activities by any EGS in Pennsylvania to secure approval from home rule municipalities or other municipalities to enter opt-out municipal aggregation contracts is contrary to the Public Utility Code and the Commission's rules and regulations, and therefore is illegal; and (2) any EGS engaged in opt-out municipal aggregation activities must cease and desist from pursuing or entering into such aggregation contracts in Pennsylvania pending any Commission investigation or until such time as these aggregation arrangements are authorized by statute or Commission rule.

By its petition, Dominion requested that the Commission declare the Meadville Ordinance, and any similar ordinances, illegal and void unless and until authorized by statute. Dominion also requested that the Commission issue an Order prohibiting any EDC or EGS from engaging in any municipal aggregation program until authorized by the General Assembly.

Subsequently, FES filed its own petition, requesting that the Commission either rule that no approvals are necessary for FES to participate in the opt-out municipal aggregation programs of Meadville, Warren, Edinboro, or Farrell or approve FES's participation in those programs.

The Commission issued a Secretarial Letter which consolidated the three aforementioned petitions and set a deadline for interested parties to file answers. The Commission also directed each EDC not to switch any customer to an EGS pursuant to an "opt-out" municipal aggregation contract and directed each EGS not to switch any customer from default service (or the customer's existing EGS) pursuant to an "opt-out" municipal aggregation contract until the legal issues are addressed and resolved by the Commission.

The OSBA filed an answer, in which the OSBA argued that until legislation is passed, it is unlawful for an EGS to enter into a contract with a home rule municipality to supply electricity through an opt-out municipal aggregation program.

By Order entered March 17, 2011, the Commission held that opt-out municipal aggregation is explicitly prohibited by statutory and regulatory provisions which require the affirmative consent of a customer before that customer's energy supplier can be changed.

Exelon-Constellation
Merger
Docket No. P-2011-2247936

On April 28, 2011, Exelon Corporation ("Exelon") and Constellation Energy Group ("Constellation" and together the "Companies") announced that they had reached an agreement to combine the two companies in a stock-for-stock transaction, expected to close in the first quarter of 2012. On May 20, 2011, the Companies filed with the Federal Energy Regulatory Commission ("FERC") a "Joint Application for Authorization of Disposition of Jurisdictional Assets and Merger Under Sections 203(a)(1) and 203(a)(2) of the Federal Power Act" at Docket No. EC11-83-000.

Exelon and Constellation have taken the position that the Commission does not have jurisdiction over the proposed merger. Therefore, they have not filed an application for a Certificate of Public Convenience pursuant to Section 1102(a)(3) of the Public Utility Code, 66 Pa.C.S. §1102(a)(3), or made any other filing seeking Commission approval of any aspect of the proposed merger.

The proposed merger could result in anticompetitive conduct and the unlawful exercise of market power because of the elimination of one retail electricity supplier, one natural gas retail supplier, and one wholesale electricity supplier. Consequently, the proposed merger could adversely affect the rates paid by small business customers for electricity and for natural gas.

Therefore, on June 16, 2011, the OSBA initiated a proceeding before the Commission to seek the Commission's intervention in the FERC proceeding regarding the proposed merger and to bring Constellation and Exelon before the Commission in order to protect the interests of small business customers from an adverse impact on the competitive retail markets for electricity and natural gas in Pennsylvania. Specifically, the OSBA sought: (i) Commission intervention in the FERC proceeding; (ii) a Commission investigation of the proposed merger's effect on Pennsylvania's retail electricity and natural gas markets; and (iii) a declaratory order regarding the Companies' obligations with respect to their licenses as electric generation suppliers ("EGSs") and natural gas suppliers ("NGSs").

The Commission filed a Motion to Intervene in the FERC Proceeding on June 30, 2011, thereby rendering the OSBA's first request for relief moot.

Subsequently, the OSBA requested to hold its petition for declaratory orders regarding the Companies' NGS and EGS licenses in abeyance until such time as the Companies commence to consolidate their respective retail marketing businesses.

The Commission has assigned this case to the Office of Administrative Law Judge for hearing and the preparation of a recommended decision on the remaining issue, whether the Commission should investigate the proposed merger's effect on Pennsylvania's retail electricity and natural gas markets.

The matter is pending before the Commission.

6. Miscellaneous

Metropolitan Edison Company
and Pennsylvania Electric Company
NUG Stranded Costs
Docket Nos. D-2009-2093381 and D-2009-2093382

By Order entered October 20, 1998, at Docket Nos. R-00974008 and R-00974009, the Commission provided for the annual audit of non-utility generation ("NUG") related stranded cost recovery by the Metropolitan Edison Company ("MetEd") and the Pennsylvania Electric Company ("Penelec") (collectively, "the Companies") through the Competitive Transition Charge ("CTC").

On August 6, 2009, the Commission entered a Tentative Order giving the parties 30 days to comment upon certain findings that were raised in the Audit Reports of 2008 stranded cost recovery. Those findings related to the accounting methods used by the Companies regarding allocation of revenues between NUG and non-NUG stranded costs and, in particular, the practice of using a NUG credit to reduce non-NUG stranded costs.

The OSBA filed Comments, taking the position that NUG credits could not be used to reduce non-NUG stranded cost balances. As pointed out by the OSBA, this accounting practice will inflate the amount of NUG stranded costs collected from MetEd's ratepayers and also enable MetEd to collect non-NUG stranded costs to which it is not entitled. The Companies filed a response, in which they disagreed with the OSBA. However, the Commission did not take final action on the matter.

During 2010, the Bureau of Audits prepared similar Audit Reports for the year ended December 31, 2009. The OSBA filed additional Comments, noting that Met-Ed's NUG stranded cost balance as of December 31, 2008, was unchanged from the previous Audit Report and, therefore, that Met-Ed's stranded cost balance continues to be $14.7 million too high.

At its public meeting of July 29, 2010, the Commission adopted an Order approving the 2010 Audit Reports. However, the Commission did not adjudicate the issue on which the OSBA commented, *i.e.*, the proper balance as of December 31, 2008.

On January 30, 2012, the Commission entered its final order in the case, disagreeing with the position taken by the OSBA, and approving the accounting method used by Met-Ed relative to its treatment of NUG over-collection revenue.

B. Gas Highlights

The rates charged by a natural gas distribution company ("NGDC") include both the cost of the gas and the cost of delivering, *i.e.*, distributing, that gas through the NGDC's pipes to customers' premises. The cost of the gas includes the amount paid by the NGDC for the gas itself, the amount paid by the NGDC to transport the gas from the well to the utility's service territory, and the amount (if any) paid by the NGDC to store the gas until customers need it.

The NGDC is required to acquire gas and to deliver it through the NGDC's pipes for non-shopping customers, *i.e.*, sales customers. The NGDC is also required to use its pipes to deliver gas purchased by shopping customers, *i.e.*, transportation customers, from natural gas suppliers ("NGSs"). The NGDC collects the cost of the gas from its non-shopping customers through the Gas Cost Rate ("GCR"). The NGDC collects the delivery costs from both shopping and non-shopping customers through distribution rates.

1. Distribution Rates

Columbia Gas of Pennsylvania
Base Rate Increase
Docket No. R-2010-2215623

On September 29, 2010, Columbia Gas of Pennsylvania, Inc. ("Columbia" or the "Company") filed a tariff proposing a modification to its tariff to provide for a BTU content adjustment to the monthly determination of a customer's bill, which has historically been billed on a volumetric basis. The OSBA filed a complaint on October 22, 2010. That proceeding was assigned to Docket No. R-2010-2201974.

On January 14, 2011, Columbia Gas of Pennsylvania ("Columbia" or "the Company") filed a tariff to raise distribution rates by $37.8 million per year. The OSBA filed a complaint on February 3, 2011. That proceeding was assigned to Docket No. R-2010-2215623.

Columbia filed a Motion to Consolidate the two proceedings, which was unopposed and approved by the Commission.

After lengthy negotiations among the parties, a partial settlement of issues was reached. The two issues which were not settled were the residential rate design and Columbia's CAP-Plus program for low-income customers. These two issues were reserved for briefing.

The OSBA filed testimony agreeing in part, and opposing in part, the Company's BTU proposals. In the BTU-adjustment proceeding, the OSBA agreed conceptually with

Columbia that the value of gas is in its heat content (BTU), not its volume. However, the OSBA's witness testified (prior to consolidation of the cases) that the issue of modifying billing practices to account for BTU-content is impermissible single-issue ratemaking. This objection was resolved through the consolidation of the BTU and distribution rate cases.

The OSBA had additional concerns regarding the determination of BTU content during the interim period when customers are still billed on a volumetric basis. These were resolved in the settlement through the adoption of a dekatherm ("Dth") billing basis by the Company, and by the adoption of an average Dth per Mcf that was consistent with the OSBA testimony.

The OSBA also took issue with the methodology used in the cost-of-service studies ("COSS") presented by the Company. An additional COSS was presented by the OCA. No specific COSS was adopted in the settlement, which resolved the OSBA's concern.

Additionally, the OSBA and others proposed different allocations of revenue to the Company's various customer classes. The revenue allocation adopted in the settlement is within the range of the proposals presented by the parties, and therefore is a reasonable compromise which the OSBA supports.

The OSBA is not a signatory to each item in the partial settlement, but does not object to any of the provisions.

The OSBA submitted a main brief and reply brief on the reserved issues.

The Administrative Law Judge issued a recommended decision on August 1, 2011. The Commission entered an opinion and order on October 14, 2011, approving the settlement and resolving the residential rate design and CAP-Plus issues.

Peoples Natural Gas Company
Base Rate Increase
Docket No. R-2010-2201702

On October 28, 2010, the Peoples Natural Gas Company ("Peoples" or the "Company") submitted a filing with the Commission that proposed to increase the company's rates by $70.2 million per year.

On November 17, 2010, the OSBA filed a complaint against the proposed increase.

A prehearing conference was held before an ALJ on December 20, 2010, and a procedural schedule was set. The OBSA submitted direct, rebuttal, and surrebuttal testimony.

A settlement was reached among the parties in this proceeding. The settlement adopted nearly all of the OSBA's recommendations set forth in its testimony.

First, the settlement limited the overall amount of the revenue increase to provide Peoples with a return on equity of less than 10.4%. Peoples originally requested 11.60%, and the OSBA submitted testimony recommending that People's return on equity be set at 10.4% or less.

Second, Peoples submitted a Cost of Service Study ("COSS") in this proceeding. The OSBA identified a number of errors with that COSS. Peoples accepted the OSBA corrections and re-ran its COSS.

Third, the OSBA recommended changes to People's revenue allocation proposal. Specifically, the OSBA argued to provide rate relief to People's small business customers, while simultaneously providing a measure of relief to People's large commercial customers. The settlement adopted the OSBA's position.

Fourth, the parties agreed to request a Commission investigation into the gas-on-gas competition which is unique to western Pennsylvania. The OSBA has advocated for this investigation in this and other proceedings.

Fifth, the settlement withdrew People's proposed distribution system improvement charge mechanism.

The Commission entered an order on June 9, 2011, approving the settlement.

UGI-Central Penn Gas
Base Rate Increase
Docket No. R-2010-2214415

On January 14, 2011, UGI – Central Penn Gas, Inc. ("CPG" or "Company") filed a tariff to increase base rates by $16.46 million per year.

On February 3, 2011, the OSBA filed a complaint against the proposed rate increase.

A prehearing conference was held before an ALJ on March 31, 2011, and a procedural schedule was set. The OBSA submitted direct, rebuttal, and surrebuttal testimony.

A settlement was reached among the parties in this proceeding. The settlement adopted the OSBA's recommendations set forth in its testimony.

First, the settlement limited the overall amount of the revenue increase to provide CPG with a return on equity of less than 10.0%. CPG originally requested 11.60%, and the OSBA submitted testimony recommending that CPG's return on equity be set at 10.0% or less.

Second, CPG proposed the realignment of a number of its customer classes. The OSBA supported the proposed realignment, but recommended changes to the revenue allocation and rate design to lessen the impact of the realignment upon CPG's small business customers. The settlement adopted the OSBA's recommended changes.

Third, CPG submitted a Cost of Service Study ("COSS") in this proceeding. The OSBA identified a number of errors with that COSS. CPG adopted the OSBA corrections and submitted a revised COSS.

Fourth, the OSBA made significant changes to CPG's revenue allocation proposal. Specifically, the OSBA argued to significantly reduce the rate increases to two customer classes that were receiving huge increases under the Company's proposal. The settlement adopted the OSBA's position.

Fifth, the OSBA also made changes to CPG's rate design proposal for two customer classes. As discussed above, CPG proposal a realignment of rate classes. That realignment, as well as CPG's proposed revenue allocation, had a large impact on the rates of two small business customer classes. The OSBA recommended changes to the rate design for those two classes to significantly reduce that impact. The settlement adopted the OSBA recommendations.

Sixth, the OSBA proposed a number of changes to CPG's proposed Energy Efficiency and Conservation ("EE&C") program. The settlement adopted most of the OSBA's proposals, including a reduction in the amount of money small businesses would pay for subsidizing the program.

Seventh, the OSBA recommended the removal of CPG's proposed Conservation Development Rider ("CDR"). The settlement followed the OSBA's recommendation and removed the CDR from this proceeding.

Eighth, the OSBA recommended the removal of the Natural Gas Vehicle Pilot Program ("NGVP Program"). The settlement followed the OSBA's recommendation and removed the NGVP Program from this proceeding.

On August 19, 2011, the Commission approved the settlement with certain modifications to the EE&C program.

2. Gas Cost Rates

Section 1307(f) of the Public Utility Code requires the Commission to conduct an annual review of the gas purchasing practices of each of the major NGDCs. At the conclusion of the review, the Commission must establish the Gas Cost Rate ("GCR") for the NGDC and must deny recovery of any costs which are unjust and unreasonable or otherwise inconsistent with a least cost procurement policy.

During 2011, the OSBA participated in the following GCR cases: T. W. Phillips Gas, at Docket No. R-2010-2211668; National Fuel Gas, at Docket No. R-2011-2218386; Philadelphia Gas Works, at Docket No. R-2011-2224739; Peoples Natural Gas Company, at Docket No. R-2011-2228694; Equitable Gas Company, at Docket No. R-2011-2223563; Columbia Gas of Pennsylvania, at Docket No. R-2011-2228696; PECO Gas, at Docket No. R-2011-2239263; UGI Utilities-Gas Division, at Docket No. R-2011-2238953; UGI Central Penn Gas, at Docket No. R-2011-2238949; and UGI Penn Natural Gas, at Docket No. R-2011-2238943.

A major priority for the OSBA in the 2011 cases was assuring that the NGDCs continued to make progress in reducing their lost-and-unaccounted-for gas ("LUFG") rates. LUFG occurs primarily because of leaks and inaccurate measurement. LUFG is costly for both non-shopping customers, *i.e.*, sales customers, and shopping customers, *i.e.*, transportation customers, because those customers must pay for extra gas that would not be needed if the LUFG rate were lower.

In addition, the OSBA focused on making sure that sales and transportation customers were paying for only their share of the LUFG, *i.e.*, that there were minimal (if any) cross-subsidies between sales and transportation customers and that there were minimal (if any) cross-subsidies among the various transportation customers in the same rate class.

The OSBA also sought to assure that the NGDCs had implemented all elements of the settlements in prior years' Section 1307(f) cases.

3. Mergers and Acquisitions

Peoples Natural Gas Company
Sale of Storage
Docket No. A-2010-2203699

On October 6, 2010, Peoples Natural Gas Company ("Peoples" or "Company") filed an application with the Commission to lease the claimed excess storage capacity at the Company's Rager Mountain Storage Facility and to transfer a portion of base and working gas in that facility.

The OSBA filed a notice of intervention in this case on November 8, 2010.

Rager Mountain is a storage field with a total capacity of 20.5 Bcf. Of that total capacity, 7.3 Bcf is usable as working gas capacity for on-system customers. Over the last five years, about 5.6 Bcf has been withdrawn every year for use by the Company's on-system customers. Simply put, Rager Mountain has capacity that is not being utilized by Peoples' customers.

A settlement was reached among the parties to resolve how to best use the Rager Mountain facility. The settlement requires Peoples to make a series of improvements to the facility, which will ultimately allow Rager Mountain to be a much more useful storage facility. Furthermore, the settlement provides a mechanism by which unused and excess capacity at Rager Mountain will be sold at market prices. People's ratepayers will share in the profits from the sale of that gas, providing a degree of rate relief for Peoples' firm service and transportation customers. The OSBA supported this result as a fair, just, and reasonable use of Rager Mountain's unused and excess capacity.

The Commission approved the settlement on April 29, 2011.

T. W. Phillips Gas & Oil Company
Sale
Docket No. A-2010-2210326

On November 10, 2010, a Joint Application was filed with the Commission to transfer all of the shares of stock in T. W. Phillips Gas and Oil Company ("T.W. Phillips" or "Company") to SteelRiver Infrastructure Investment Fund ("Steel River").

On December 13, 2010, the OSBA filed a Notice of Intervention in this proceeding.

The parties were able to reach a settlement of this proceeding. Because this case involved the change of ownership of T.W. Phillips, the transaction must produce substantial public benefits. Further, because the change of ownership involved a natural gas utility, the Public Utility Code requires that the transaction not be anticompetitive.

The OSBA served direct testimony in this proceeding. The OSBA did not find that the transaction, in and of itself, provided any substantial public benefit. However, the settlement reached by the parties affirmatively provided substantial public benefits while not violating the statutory mandate against an anticompetitive result. Set forth below are issued addressed by the OSBA that were included in the settlement agreement.

First, the settlement requires the new owner, Steel River, to commit to capital improvements to the T.W. Phillip system.

Second, the settlement requires that T.W. Phillips work to materially reduce its currently high level of lost and unaccounted for gas.

Third, the settlement requires that T.W. Phillips be operated as a separate NGDC from Peoples Natural Gas (which is also owned by Steel River). Among other reasons, this will address many of the anticompetitive concerns raised by this transaction.

Fourth, the President and CEO of Peoples would not be allowed to fill those roles at T.W. Phillips after the transaction as originally proposed by Steel River. The settlement requires that two different individuals serve as the CEO and President of the two NGDCs.

The Commission approved the settlement on May 23, 2011.

4. <u>Miscellaneous</u>

UGI-Penn Natural Gas Co.
Sale to Affiliated Interest
Docket Nos. A-2010-2213893 and G-2010-2213894

On December 1, 2010, UGI Penn Natural Gas, Inc. ("PNG") filed for Commission approval of the sale of pipeline facilities to UGI Energy Services, Inc. ("UGIES"). The pipeline facilities were used to serve numerous retail customers. The subject of the proposed sale is a 9.0 mile natural gas pipeline, appurtenant facilities, and right-of-way located between Auburn and Mehoopany, Pennsylvania ("Auburn Line"); PNG's interest in an interconnection agreement with PVR Marcellus Gas Gathering, LLC. ("PVR"), which is the owner of a gathering line between the Auburn Line and local gas wells; and the interconnection facilities associated with that interconnection agreement.

PNG used the Auburn Line primarily to transport gas received from the Tennessee Gas Pipeline Company ("Tennessee") and the PVR gathering line to a manufacturing plant owned by the Procter and Gamble Paper Products Company ("P&G"). PNG also used the Auburn Line to provide gas service to numerous retail customers of PNG.

The proposed sale was apparently prompted by a request from Citrus Energy Corporation ("Citrus") to inject Marcellus Shale gas into the Auburn Line to serve P&G and to reverse the flow of the Auburn Line so that excess volumes of that gas can be delivered into the Tennessee pipeline. UGIES will upgrade the Auburn Line, subsequent to approval, in order to facilitate the request from Citrus Energy.

PNG represented that the proposed sale would benefit P&G and the local economy, would improve distribution system reliability, and would make lower cost gas available to PNG's retail customers. However, the OSBA determined that the Application raised significant questions, including (but not limited to) the following, which must be answered adequately prior to Commission action on the Application:

a. What is the economic value of the Auburn Line to UGIES? Is the economic value of the Auburn Line greater than the sale price proposed in this Application? If so, should PNG's ratepayers share in the net economic value that UGIES may be able to achieve from the Auburn Line, in that those ratepayers have presumably paid for PNG's capital investment in the Auburn Line, provided a return on PNG's capital investment in the Auburn Line, and paid for the ongoing operation and maintenance of the Auburn Line?

b. How was the proposed sale price established? Was it an arms-length transaction? Would a sale of the Auburn Line to an entity other than an affiliated interest of PNG be more beneficial to ratepayers than a sale to UGIES?

c. What impact would the proposed sale have on the gas currently injected into the Auburn Line from PVR's gathering system?

d. Would the proposed sale of the Auburn Line increase, decrease, or have no effect on the purchased gas cost ("PGC") rates charged to PNG's retail customers?

e. What, if any, impact would the proposed sale of the Auburn Line have on the costs imposed on PNG's retail customers related to lost-and-unaccounted-for-gas ("LUFG")?

f. What impact would the proposed sale of the Auburn Line have on the ability of PNG's retail customers served by that line to shop for gas?

g. Is the claimed improvement in the reliability of the distribution system a material public benefit?

Following the filing of testimony, a settlement was reached by some of the parties. However, the OSBA was not a settling party. The OSBA's major objection to the transaction and the settlement was that the sale Auburn Line by PNG to an affiliated interest at less than fair market value is not permitted under the Public Utility Code.

On May 11, 2011, the ALJ issued an initial decision in the proceeding approving the settlement. Thereafter, the OSBA filed exceptions to the initial decision.

On July 25, 2011, the Commission approved the settlement and dismissed the OSBA's protest.

C. Telephone Highlights

1. Access Charges

Verizon Pennsylvania Inc.
Access Charges
Docket No. C-20027195

This proceeding is the latest in a series of cases beginning with the 1999 Global Order at Docket Nos. P-00991648 and P-00991649, the 1999 Verizon North and Verizon Pennsylvania ("Verizon" or the "Company") Merger Order at Docket No. A-310200, and the 2002 Generic Access Charge Investigation at Docket No. M-00021596.

On March 21, 2002, AT&T filed a complaint against Verizon North seeking to have that company's access charges reduced to the levels of Verizon Pennsylvania, as required by the Merger Order. AT&T's complaint was docketed at C-20027195.

During litigation, Verizon and the OCA submitted a settlement that limited the total local exchange rate increase that could be recovered from the Company's residential customers on a combined Verizon North and Verizon Pennsylvania basis. In addition, specific residential rate increases would be held to $1.00 per month or less. The settlement provided for Verizon's business customers to pay the balance of the remaining local exchange rate increase, on a combined Verizon North and Verizon Pennsylvania basis.

The OSBA opposed the Verizon-OCA settlement. The OSBA argued that Verizon did not meet its burden of proof because the Company failed to detail how business rates would be affected by the Verizon-OCA settlement. However, in the October 31, 2003, Recommended Decision ("RD"), the administrative law judge ("ALJ") recommended that the Verizon-OCA settlement be approved because six of the seven parties that presented witnesses agreed with portions of the settlement.

The OSBA filed exceptions and reply exceptions to the RD.

On February 26, 2004, Verizon, the OCA, and the OSBA reached an agreement on the issues litigated by the OSBA. The Verizon-OCA-OSBA settlement limited the specific business rate increase to less than $1 per business line per month, and provided that the average increase for business local exchange lines could not be greater than the average increase for residential local exchange lines.

On July 28, 2004, the Commission entered an order that adopted the Verizon-OCA-OSBA settlement. In addition, the Commission remanded the case to the Office of Administrative Law Judge for the further development of a record, and issuance of a recommended decision, on issues that were not decided in the July 28, 2004, Opinion and

Order. The issues on remand include (but are not limited to) the consideration of specific access charge reduction proposals, the removal of implicit subsidies from access charges, and the reduction or elimination of the carrier charge.

On December 7, 2005, the ALJ issued an RD in the remand proceeding. Thereafter, the OSBA submitted exceptions and reply exceptions in response to the RD.

The OSBA and several other parties had argued that the Verizon Access Charge Remand case should be stayed, pending the outcome of the In re Developing a Unified Intercarrier Compensation Regime, (FCC Rel.: March 3, 2005), CC Docket No.01-02, Further Notice of Proposed Rulemaking, FCC 05-33 ("Unified Intercarrier Compensation") proceeding at the Federal Communications Commission ("FCC"). Therefore, the OSBA excepted to the ALJ's recommendation against waiting for the Unified Intercarrier Compensation proceeding to conclude.

The ALJ had also recommended that Verizon's carrier charge be eliminated. The OSBA excepted to this recommendation, observing that the contribution of the interexchange carriers ("IXCs") to the cost of the local loop is already far below their appropriate share of those costs. Eliminating the carrier charge will simply exacerbate that problem. The ALJ also recommended reducing Verizon's other access charges to their interstate levels, to which the OSBA excepted for the same reasons it opposed elimination of the carrier charge. In addition, the OSBA excepted to the ALJ's recommendation that all access charge reductions occur over a very short time period.

If access charges are eliminated or reduced, Verizon will suffer a loss of revenues. Under Chapter 30, Verizon may seek to replace those lost revenues by requesting an increase in its local exchange rates. The ALJ recommended that Verizon's non-contract customers pay for the entire offsetting local exchange rate increases caused by Verizon's loss of access charge revenue and that none of the increased rates be borne by Verizon's contract customers. The OSBA excepted to this recommendation as a violation of the express language of 66 Pa. C.S. § 3016(f)(1), which forbids requiring non-competitive services to subsidize competitive services.

In addition, the ALJ recommended that rate caps be placed upon Verizon's residential customers, so that any local exchange rate increase will be capped for residential customers, but not for business customers. There is no record evidence to support the ALJ's recommendation. The OSBA excepted to this recommendation and argued that the matter of the proper allocation of any rate increase should be addressed in a further proceeding.

On January 8, 2007, the Commission ordered that this case be stayed, pending the outcome of the FCC's Unified Intercarrier Compensation proceeding or until January 8, 2008, whichever arrived first. The Commission expressed concern the FCC proceeding might impact this case in significant and unpredictable ways, and concluded that coordinating its actions with those of the FCC would be the best way to proceed.

In the fall of 2007, Verizon and certain other parties petitioned the Commission to extend the stay, while several other parties opposed any additional stay. On September 12, 2008, the Commission entered an order extending the stay until September 12, 2009, or until a final outcome in the FCC's Unified Intercarrier Compensation proceeding, whichever occurs first. Thereafter, the Commission further stayed the proceeding.

However, on May 11, 2010, the Commission entered an Order denying yet another Motion to Extend the Stay. The Commission ordered that this case be assigned to an ALJ for further proceedings and to update the record.

On December 8, 2010, a prehearing conference was held before an ALJ, and a new procedural schedule was set for this case.

The OSBA served direct, rebuttal, and surrebuttal testimony.

Evidentiary hearings were held before an ALJ in June 2011.

The OSBA submitted both a main brief and a reply brief.

At the time of this writing, the parties are awaiting a Recommended Decision from the ALJ.

Rural Local Exchange Carriers
Access Charges
Docket No. I-00040105

On December 20, 2004, the Commission entered an Order instituting an investigation into whether there should be further intrastate access charge reductions and intraLATA toll rate reductions in the service territories of rural incumbent local exchange carriers ("RLECs"). The investigation was instituted as a result of the Commission's prior Order entered July 15, 2003, at Docket No. M-00021596, which discussed implementing continuing access charge reform in Pennsylvania. The July 15, 2003, Order also provided that a rulemaking proceeding would be initiated no later than December 31, 2004, to address possible modifications to the Pennsylvania Universal Service Fund ("PAUSF") regulations.

The December 20, 2004, Order directed that the Office of Administrative Law Judge conduct a proceeding to develop a record and present a recommended decision on a variety of questions related to access charge reform.

The ALJ conducted two prehearing conferences in February and April 2005. On May 23, 2005, the OSBA and other parties filed a Motion to Defer this proceeding. Specifically, the parties requested a stay of the investigation because it would be unreasonable for the Commission to take action prior to the conclusion of the FCC's Unified Intercarrier Compensation proceeding. The FCC proceeding had the potential to impact directly, if not render moot, the universal service and access charge issues in the Commission's proceeding. On August 30, 2005, the Commission granted the Motion to Defer.

On August 30, 2006, certain parties petitioned the Commission to further stay this proceeding for another 12 months, or until the conclusion of the FCC's Unified Intercarrier Compensation proceeding, whichever arrived first. On November 15, 2006, the Commission granted that petition and further stayed this proceeding.

On April 24, 2008, the Commission entered an order that generally continued the stay of this proceeding, but reopened the investigation for the limited purpose of addressing whether the cap of $18.00 on residential monthly local exchange service rates, and any corresponding cap on business monthly local exchange service rates, should be raised.

The OSBA filed direct, rebuttal, and surrebuttal testimony in the limited investigation.

In the Recommended Decision in the limited proceeding, the ALJ agreed with the OSBA that there are no caps on local exchange rate increases resulting from the annual price change opportunity ("PCO") filings made by the RLECs. The ALJ also agreed with the OSBA that the PAUSF should not be used to mitigate rate increases resulting from those annual PCO filings. Furthermore, the ALJ agreed with the OSBA that the PAUSF should be reformed to focus on low-income customers.

Several parties filed exceptions to the ALJ's Recommended Decision in the limited proceeding. The OSBA filed reply exceptions on a number of issues. The Commission has not yet acted on the Recommended Decision or on the exceptions thereto.

By Order entered August 5, 2009, the Commission also lifted the stay on the remainder of the access charge investigation it had ordered in 2004.

In this second proceeding, the OSBA filed direct, rebuttal, and surrebuttal testimony. The OSBA also filed a main brief and a reply brief.

In the Recommended Decision in the second proceeding, the ALJ assigned the burden of proof to the RLECs, rather than to AT&T, which had filed the complaint. The OSBA excepted to this recommendation. In addition, the ALJ recommended the adoption of AT&T's proposal to reduce each RLEC's intrastate access rates to the level of that RLEC's interstate access rates. The OSBA did not except to the conclusion reached by the ALJ, but the OSBA did except to AT&T's methodology for calculating the reduction. Finally, the ALJ recommended what amounted to a new rate cap by creating an "affordability standard" for rates. The OSBA excepted to this recommendation, as there is no need for the Commission to treat all RLEC customers as low-income customers in need of assistance.

The OSBA also filed reply exceptions.

On July 18, 2011, the Commission entered an order in this proceeding. The Commission order supported the arguments made by the OSBA throughout the long course of this proceeding. Access reductions were required, but required a contribution towards the cost of the RLEC's local loop through the use of a $2.50 carrier charge. Furthermore, the Commission clarified that there is no cap on residential rates, thus not requiring small business customers to be the "payors of last resort."

On August 2, 2011, AT&T filed a Petition for Reconsideration with the Commission. The OSBA filed an Answer opposing AT&T's Petition on August 12, 2011.

At the time of this writing, the parties are awaiting a substantive decision by the Commission on the AT&T Petition.

2. <u>Mergers and Acquisitions</u>

Embarq Communications, Inc.
Change of Control
Docket No. A-2008-2076038
496 CD 2010

In November of 2008, the United Telephone Company of Pennsylvania LLC d/b/a/ Embarq Pennsylvania and Embarq Communications, Inc. ("Applicants") filed an application with the Commission seeking approval for the indirect transfer of control of the Applicants to CenturyTel, Inc. The application proposed to carry out the transfer of control through a stock-for-stock transaction between CenturyTel and the Applicants' parent, Embarq Corporation.

Under appellate case law, the Commission is not permitted to approve a change of control unless the transaction would provide substantial affirmative public benefits. The OSBA was not able to identify any substantial affirmative public benefit that would arise from this proposed transaction. Consequently, the OSBA filed direct, rebuttal, and surrebuttal testimony in opposition to the transaction.

In his Initial Decision ("ID"), the administrative law judge ("ALJ") recommended that the Commission approve the transaction without any of the conditions proposed by any non-company party. The OSBA filed a single exception to the ID, arguing that the ALJ made an error when he rejected the OSBA's proposed condition to share the synergy savings with customers via a freeze in noncompetitive service rates for five years.

By Order entered on May 28, 2009, the Commission approved the transaction and the issuance of a certificate of public convenience, subject to acceptance by the Joint Applicants of certain conditions. However, the Commission expressly denied the OSBA's exception and expressly rejected the OSBA's proposed condition. In so doing, the Commission embraced the ALJ's view that it is an affirmative public benefit for the synergy savings to be used to strengthen Embarq PA as a competitor.

On June 26, 2009, the OSBA filed a Petition for Review with the Commonwealth Court. The OSBA contended that the Commission violated Pennsylvania law when it concluded that strengthening Embarq PA as a competitor was an affirmative benefit of the transaction. As the OSBA pointed out, the premise of Chapter 30 is that competition will be an effective way to control telecommunications rates. However, providing Embarq PA with money it can use to undercut its competitors' prices is tantamount to giving the utility a weapon with which to drive competitors out of the market, after which Embarq PA will be able to raise its rates.

On August 31, 2009, the Commission filed an Application for Remand with the Commonwealth Court. The stated purpose of the remand was to consider imposing some conditions approved by the Federal Communications Commission ("FCC"). The OSBA opposed the Application. Nevertheless, the Commonwealth Court agreed to remand the proceeding to the Commission for the limited purpose of considering the imposition of some or all of the FCC conditions.

On November 25, 2009, the Commission issued a Tentative Order regarding the FCC conditions, and invited the comments of interested parties. The OSBA did not file comments to the Commission's Tentative Order. However, based upon the conflicting comments of other parties, the OSBA filed reply comments requesting that the matter be sent to the Office of Administrative Law Judge for hearings.

On March 1, 2010, the Commission entered an Order in which it rejected the OSBA's request for hearings and essentially adopted the additional conditions set forth in its November 25th Order.

On March 30, 2010, the OSBA filed another Petition for Review, seeking review by the Commonwealth Court of the Commission's May 28th and March 1st Orders.

The OSBA filed a brief and a reply brief with the Commonwealth Court.

On December 6, 2010, the Commonwealth Court heard oral argument in this case.

By Opinion and Order issued March 1, 2011, the Commonwealth Court upheld the Commission's approval of the merger. In the Court's view, there was substantial evidence supporting the Commission's conclusion that the merger would produce net affirmative benefits.

D. Water and Wastewater Highlights

City of Lancaster-Water
Base Rate Increase
Docket No. R-2010-2179103

On August 27, 2010, the City of Lancaster – Bureau of Water ("Lancaster" or "City") filed a tariff to increase total annual operating revenues by $8,608,024 per year, *i.e.*, by 99.8%.

On October 5, 2010, the OSBA filed a complaint against the proposed rate increase. Subsequently, the OSBA filed testimony. In that testimony, the OSBA opposed the rate increase as excessive. The OSBA also objected to proposals of other parties to shift a bigger percentage of the rate increase to Commercial customers.

Evidentiary hearings were held at which the testimony and exhibits of witnesses were admitted into the record.

The OSBA and other parties filed main briefs and reply briefs. After the filing of briefs, the administrative law judge issued a Recommended Decision in this case on April 27, 2011.

Subsequent to the filing of exceptions, the Commission entered an Order on July 14, 2011, approving an increase in rates of $5,786,743 (67.1%), as opposed to the initial proposal from the City of $8,608,024 (99.8%). At the awarded revenue requirement level, small business customers saved $795,406 per year, as measured by the difference between the increase assigned by the Commission to small business customers and the increase advocated by the Office of Consumer Advocate ("OCA").

Pennsylvania American Water Company
Base Rate Increase
Docket No. R-2011-2232243

On April 29, 2011, Pennsylvania-American Water Company ("PAWC" or the "Company") filed a tariff to increase the Company's base rates by $70.7 million per year, which would result in a rate of return on equity ("ROE") of 11.5%.

The OSBA filed a complaint and testimony against the proposed increase.

The OSBA objected to the Company's request for an ROE of 11.5%. Based on recent Commission precedent and the effect of the recession on equity returns, the OSBA proposed that the Company be awarded an ROE of no more than 10%.

The OSBA did not object to the Company's proposed revenue allocation with respect to the Commercial and Industrial classes, finding it to be reasonable and cost-based.

The OSBA did object to a proposal by the OCA that would have assigned an even greater share of the rate increase to private fire customers than proposed by the Company. OCA proposed a revenue allocation that left private fire rates unchanged, but rolled-in the 5.6% DSIC. The result of this proposal would have been a $172,938 increase in base rates for the private fire class, who were already paying rates above cost of service.

In addition, the OSBA objected to a proposal by AK Steel for industrial customer charges that were not cost-based.

The OSBA also took issue with the OCA's proposal that PAWC complete a new customer class demand study prior to its next base rate case. The OSBA did not oppose a new demand study in principle, but had two concerns with the OCA's proposal: (1) how much the demand study would cost and how those costs were to be recovered from ratepayers; and (2) whether completing the new study prior to PAWC's next base rate case is feasible.

Finally, the OSBA opposed the Company's proposed Purchased Power Adjustment Charge and the Purchased Water Adjustment Charge that would allow PAWC to change rates between rate cases.

After the filing of testimony, the parties reached a settlement that mitigated the OSBA's concerns.

First, the settlement increased PAWC's revenues by approximately $36 million instead of the $70.7 million originally requested by the Company. Consequently, the revenue increase provided by the settlement equated to an implicit ROE for PAWC that was below the 10% ceiling recommended by the OSBA.

Second, the settlement adopted the Company's proposal to leave private fire rates unchanged and to not roll-in the current DSIC surcharge of 5.6%. Although the private fire class is above cost of service at present rates and would remain above cost of service at the Company's proposed rates, refraining from rolling in the DSIC and keeping private fire rates unchanged allows this over-paying rate class to move closer to its cost of service.

Third, the settlement rejected AK Steel's proposal with respect to customer charges for industrial customers that were not cost-based and instead adopted the Company's proposal.

Fourth, the settlement addressed the OSBA's concerns regarding the cost and feasibility of a new customer class demand study prior to PAWC's next base rate case. The settlement provides for a new demand study only if, after discussing the specifics of the plan to perform the study, the parties agree that it is appropriate for such a study to be completed. The study will be deemed completed and will be submitted as part of the Company's testimony in its next base rate case only if at least one year of data has been collected and analyzed. The settlement preserves the right of any party to oppose the Company's use of the study to allocate costs in its next base rate case or to oppose the amount and/or method of PAWC's recovery of the cost of the new demand study.

Fifth, the Company withdrew the proposed Purchased Power Adjustment Charge and the Purchased Water Adjustment Charge.

By Order entered November 11, 2011, the Commission approved the settlement.

On February 8, 2012, the Company distributed to the parties a study of the feasibility and cost of conducting a customer class demand study. At the time of this writing, the study, conducted by Gannett Fleming at PAWC's request, is currently being reviewed by the parties.

United Water Company
Base Rate Increase
Docket No. R-2011-223985

On May 9, 2011, United Water Pennsylvania, Inc. ("United" or "the Company") filed a tariff to increase revenues by $2.85 million.

On May 25, 2011, the OSBA filed a complaint against the proposed rate increase. Subsequently, the OSBA filed testimony in which the OSBA opposed the rate increase as reflective of an excessive return on equity. However, the OSBA did agree with the revenue allocation proposed by United.

After several negotiation conferences, the parties, including the OSBA, agreed to a settlement which was filed with the Commission on September 28, 2011. The settlement addressed the OSBA's concerns regarding excessive return on equity by reducing the revenue increase to $1.45 million, which is below the maximum recommended by the OSBA. Further, the settlement scaled back the revenue increases proportionally for each rate class, as recommended by the OSBA's witness.

The Administrative Law Judge presiding over the case issued a recommended decision on October 12, 2011, recommending approval of the settlement.

The settlement was approved by Order of the Commission entered October 28, 2011.

E. Legislation

Section 9 of the Small Business Advocate Act, 73 P.S. § 399.49, requires the OSBA to make reports to the Governor and the General Assembly regarding matters within the OSBA's jurisdiction. In addition to testifying at a budget hearing before the House Appropriations Committees, the Small Business Advocate submitted written testimony to the House Consumer Affairs Committee on electric and gas retail competition. The OSBA also responded to inquiries from individual legislators and legislative staff members.

F. List of Proceedings

1. 2011 Generic Proceedings

The OSBA participates before the Commission in numerous rulemaking and other proceedings which are not specific to a single utility. In most instances, the OSBA files comments that advocate positions of particular importance to small business customers. The OSBA filed comments in 2011 in the following such proceedings:

Compliance of Commonwealth of Pennsylvania with Section 410(a) of the American Recovery and Reinvestment Act of 2009
Docket No. I-2009-2099881
Comments

American Recovery and Reinvestment Act Investigation
Docket No. I-2009-2099881
Reply Comments

Energy Efficiency and Conservation Program and EDC Plans
Docket No. M-2008-2069887
Reply Comments

Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of their Default Service Programs
Docket Nos. P-2009-2093053 and P-2009-2093054
Comments

Investigation of Pennsylvania's Retail Electricity Market
Docket No. I-2011-2237952
Comments

Natural Gas Distribution Companies and the Promotion of Competitive Retail Markets
Docket No. L-2008-2069114
Comments

Investigation re Transmission Reconciliation Service Charge (TSC) Reconciliation Methods
Docket No. M-2011-2239714
Comments

PPL Electric Utilities Corp. Proposed Transmission Service Charge (TSC) Reconciliation for the Twelve Months Ending November 30, 2010
Docket No. M-2010-2213754
Comments

Investigation re Transmission Reconciliation Service Charge (TSC) Reconciliation Methods
Docket No. M-2011-2239714
Reply Comments

Reports on the Audit of Non-Utility Generation Related Stranded Cost Recovery through the Competitive Transition Charge for Metropolitan Edison Company and Pennsylvania Electric Company
Docket Nos. D-2011-2232754 and D-2011-2232755
Comments

Petition of West Penn Power Company d/b/a Allegheny Power for Approval of its Energy Efficiency and Conservation Plan, Approval of Recovery of Costs Through a Reconcilable Adjustment Clause and Approval of Matters Relating to the Energy Efficiency and Conservation Plan
Docket No. M-2009-2093218
Comments

2. <u>2011 PUC Cases</u>

The OSBA participates in major rate increase cases before the Commission; the annual Gas Cost Rate cases for Pennsylvania's largest gas companies; and a number of other formal proceedings involving disputes over the kinds of services made available to, or the prices charged to, the small business customers of electric, gas, telephone, water, steam, and wastewater utilities. In addition to continuing to participate in cases carried over from preceding years, the OSBA entered its appearance in the following new proceedings in 2011:

Electric

Petition of West Penn Power Company d/b/a Allegheny Power for Approval of its Dynamic Pricing Plan for Time-of-Use Rates **(P-2011-2218683)**

Petition of West Penn Power Company for Approval of its Dynamic Pricing Plan for a Residential Critical Peak Rebate Offering and a Non-Residential Critical Peak Pricing Rate Offering **(P-2011-2224781)**

PPL Electric Utilities Corporation Calculation of Generation Supply Charge-1 **(M-2011-2243137)**

PPL Electric Utilities Corporation Final 2011 Generation Supply Charge-1 Reconciliation Report **(M-2011-2240273)**

Re: PPL Electric Utilities Corporation Proposed Transmission Service Charge (TSC) for the Twelve Months Ending November 30, 2010 **(M-2010-2213754)**

Office of Small Business Advocate's (I) Petition Seeking Intervention by the Pennsylvania Public Utility Commission in Proceedings Before the Federal Energy Regulatory Commission Regarding the Proposed Merger of Exelon Corporation and Constellation Energy Group; (II) Complaint Seeking an Investigation by the Commission into the Proposed Merger; and (III) Petition For a Declaratory Order (A) Confirming Exelon Corporation Must Seek Prior Commission Approval of the Transfer of its Electric and Natural Gas Generation Supplier Licenses or Assignment of Customer Contracts and (B) Directing Constellation Energy Group to Notify the Commission of the Proposed Merger and File Amended License Applications **(P-2011-2247936)**

Re: Metropolitan Edison Company's Transmission Service Charge – Section 1307(e) Statement **(M-2011-2241863)**

Re: Pennsylvania Electric Company's Transmission Service Charge – Section 1307(e) Statement **(M-2011-2241892)**

Petition of Pike County Light & Power Company for Approval of Its Default Service Implementation Plan **(P-2011-2252042)**

Petition of PPL Electric Utilities Corporation for Approval to Implement a Reconciliation Rider for Default Supply Service **(P-2011-2256365)**

Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation **(M-2011-2258733)**

Pennsylvania Public Utility Commission v. PPL Electric Utilities Corporation **(R-2011-2264771)**

Gas

Pennsylvania Public Utility Commission v. National Fuel Gas Distribution Corporation **(R-2011-2218386)**

Pennsylvania Public Utility Commission v. Columbia Gas of Pennsylvania **(R-2010-2215623)**

Pennsylvania Public Utility Commission v. UGI Central Penn Gas, Inc. **(R-2010-2214415)**

Pennsylvania Public Utility Commission v. T. W. Phillips Gas and Oil Company **(R-2010-2211668)**

Pennsylvania Public Utility Commission v. Philadelphia Gas Works **(R-2011-2224739)**

Pennsylvania Public Utility Commission v. Peoples Natural Gas Company, LLC **(R-2011-2228694)**

Pennsylvania Public Utility Commission v. Columbia Gas of Pennsylvania, Inc. **(R-2011-2228696)**

Pennsylvania Public Utility Commission v. Equitable Gas Company, LLC **(R-2011-2223563)**

Pennsylvania Public Utility Commission v. PECO Energy Company **(R-2011-2239263)**

Pennsylvania Public Utility Commission v. UGI Central Penn Gas, Inc. **(R-2011-2238949)**

Pennsylvania Public Utility Commission v. UGI Penn Natural Gas, Inc. **(R-2011-2238943)**

Pennsylvania Public Utility Commission v. UGI Utilities, Inc. **(R-2011-2238953)**

Affiliated Interest Agreement Between Peoples TWP LLC and Peoples Natural Gas Company LLC **(G-2011-2265150)**

Water

Pennsylvania Public Utility Commission v. Pennsylvania-American Water Company **(R-2011-2232243)**

Pennsylvania Public Utility Commission v. United Water Pennsylvania, Inc. **(R-2011-2232985)**

Pennsylvania Public Utility Commission v City f Bethlehem – Bureau of Water **(R-2011-2244756)**

3. 2011 Appellate Court Cases

Under the Small Business Advocate Act, the OSBA is authorized to appear before the appellate courts regarding matters under the PUC's jurisdiction. In addition to participating in cases begun in prior years, the OSBA appeared in the following new appellate court case in 2011:

Metropolitan Edison Company and Pennsylvania Electric Company, Petitioners v. Pennsylvania Public Utility Commission, Met-Ed Industrial Energy Users Group, and Penelec Industrial Customer Alliance, Respondents; and Irwin A. Popowsky, Consumer Advocate, and William R. Lloyd, Jr., Small Business Advocate, Nominal Respondents **(427 EAL 2011)**

4. United States District Court for the Eastern District of Pennsylvania

The OSBA appeared in the following new federal court case in 2011:

Metropolitan Edison Company and Pennsylvania Electric Company, Plaintiffs, v. Pennsylvania Public Utility Commission, Robert F. Powelson, John F. Coleman, Jr., Pamela A. Witmer, Wayne E. Gardner, and James H. Cawley, in their official capacities as Commissioners of the Pennsylvania Public Utility Commission, Defendants **(Civil Action No. 11-4474)**

G. Small Business Consumer Outreach

In addition to its litigation caseload, the OSBA also handles individual small business consumer problems. Small business consumers usually contact the OSBA as a result of the OSBA's web page, referrals by the PUC, and referrals by legislators.

V. THE OSBA'S WORKERS' COMPENSATION ACTIVITIES

The OSBA's workers' compensation duties involve a review and evaluation of, and the submission of comments on, the "loss cost" filings that are submitted to the Insurance Department each year by the Pennsylvania Compensation Rating Bureau ("PCRB") and the Coal Mine Compensation Rating Bureau of Pennsylvania ("CMCRB"). The "loss cost" portion of a workers' compensation premium reflects the cost of paying wages for employees whose injuries prevent them from working. The "loss cost" portion of the premium also reflects the cost of medical care for injured workers. Individual workers' compensation insurers are not permitted to begin using the filed "loss costs" until the Department has approved the respective bureau's filing.

PCRB Filing

After an independent analysis of the PCRB's filing for the year beginning April 1, 2011, the OSBA recommended an overall decrease of 6.79% in statewide industrial loss costs in lieu of the 0.36% increase requested by the PCRB. Subsequently, the Department approved the PCRB's request.

CMCRB Filing

After an independent analysis of the CMCRB's filing for the year beginning April 1, 2011, the OSBA recommended an overall decrease of 20.6% in statewide loss costs in lieu of the 15.3% decrease requested by the CMCRB. Subsequently, the Department approved the CMCRB's request.

VI. OSBA STAFF

(Position Vacant)
Small Business Advocate

Steven C. Gray (10/11/94 to present)
Assistant Small Business Advocate

Sharon E. Webb (6/20/05 to present)
Assistant Small Business Advocate

Daniel G. Asmus (11/21/05 to present)
Assistant Small Business Advocate

Lauren M. Lepkoski (6/10/06 to 2/25/11)
Assistant Small Business Advocate

Elizabeth Rose Triscari (5/2/11 to present)
Assistant Small Business Advocate

Terry Sneed (7/5/05 to present)
Administrative Officer

(Position Vacant)
Legal Assistant