March 30, 2012

VIA ELECTRONIC FILING

Hon. Kimberly D. Bose, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: PPL Electric Utilities Corporation
Docket No. ER12-___-000

Dear Secretary Bose:


I. INTRODUCTION

For more than 30 years, the Commission has recognized that its policy of requiring the full normalization of income tax timing differences could result in an excess or deficiency in the deferred taxes that are deducted from a public utility’s regulatory rate base when that public utility previously has been flowing through the benefits of tax

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1 Pursuant to Order No. 714, this filing is submitted by PJM Interconnection, L.L.C. on behalf of PPL Electric as part of an XML filing package that conforms with the Commission’s regulations. PJM has agreed to make all filings on behalf of the PJM Transmission Owners in order to retain administrative control over the PJM Tariff. Thus, PPL Electric has requested PJM submit this revised Attachment H-8A in the eTariff system as part of PJM’s electronic Intra PJM Tariff.

timing differences to its ratepayers. Although natural gas pipelines regulated by the Commission had to address this mismatch between their deferred tax accounts and their future tax liability at the time Order No. 144 was adopted, that was not the case with respect to many of the public utilities regulated by the Commission under the FPA. For many years after the adoption of Order No. 144, PPL Electric, like many other public utilities, primarily served retail customers under bundled rates that recovered almost all of its transmission cost of service. These retail rates, regulated by the Pennsylvania Public Utility Commission (“PA PUC”), were established under state laws and regulatory policies that required that certain federal and state income tax savings resulting from temporary timing differences between tax and regulatory recovery be flowed through to current retail ratepayers with the full understanding, and expectation, that ratepayers would be responsible for funding the higher future taxes that would result under flow-through when these temporary timing differences reversed. The basis for that understanding and expectation was, of course, that almost all of PPL Electric’s transmission investment would continue to be recovered under the rules and policies of the PA PUC.

However, when PPL Electric implemented a formula transmission rate to recover its costs of providing transmission service under the PJM Tariff on November 1, 2008, its formula rate template followed the rules and policies of the Commission. Those rules and policies require full tax normalization. As a result of moving to full tax normalization, as anticipated by the Commission in Order No. 144, there is a difference between PPL Electric’s deferred tax account and its future tax liability, which, in accordance with the Commission’s regulations, PPL Electric has recorded in Account 182.3 since 1993. This filing seeks to recover that difference.

The proposed rate under the Monthly Deferred Tax Adjustment Charge will make PPL Electric whole for the future taxes it will have to pay as transmission-related tax timing differences reverse. The unfunded tax liability and proposed rate, described in the attached testimony of Mr. Gary L. Banzhoff and Mr. Joseph M. Kleha, have been calculated in accordance with the South Georgia Method that has been accepted by the

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4 PJM Interconnection, L.L.C., Open Access Transmission Tariff, Attachment H-8G (“Formula Rate”).


6 Prepared Direct Testimony of Gary L. Banzhoff, attached hereto as Exhibit No. PPL-100 (“Banzhoff Testimony”).

7 Prepared Direct Testimony of Joseph M. Kleha, attached hereto as Exhibit No. PPL-200 (“Kleha Testimony”).
Commission.\textsuperscript{8} Thus, PPL Electric proposes to recover its future unfunded tax liability over the remaining life of the assets in place at the time it implemented its transmission formula rate, which will result in a modest monthly fixed recovery of $130,731 or $17.37 per MW of demand at current demand levels. The charge will be recovered from network service customers that serve PPL Electric’s former bundled retail rate customers who currently take retail distribution service from PPL Electric. These are the same customers who received the benefit of the flow-through of tax savings under the PA PUC’s flow-through policies. None of PPL Electric’s former wholesale customers will be subject to the Monthly Deferred Tax Adjustment Charge. Finally, this filing does not change PPL Electric’s formula rate.

In sum, the proposed Monthly Deferred Tax Adjustment Charge is a measured and modest effort to make PPL Electric whole for income taxes it will have to pay, but which will not be recovered from ratepayers under the Commission’s tax normalization policies. PPL Electric requests that the Commission approve the Monthly Deferred Tax Adjustment Charge to become effective June 1, 2012 to coincide with the PJM rate year.

II. BACKGROUND

PPL Electric is a public utility company organized under the laws of the Commonwealth of Pennsylvania. It is a wholly owned subsidiary of PPL Corporation. PPL Electric owns transmission and distribution facilities located within PJM and currently serves approximately 1.4 million customers in 29 counties in eastern and central Pennsylvania. PPL Electric’s transmission system consists of approximately 5,000 miles of transmission lines and covers a service territory of approximately 10,000 square miles. PPL Electric also is the default supplier for retail customers within its service territory under Pennsylvania’s Electricity Generation Customer Choice and Competition Act, 66 Pa.C.S. § 2801, \textit{et seq}. From 1981 to 1997, almost all of PPL Electric’s transmission revenue requirement was collected through bundled retail rates.\textsuperscript{9} In accordance with a decision by the PA PUC in 1981, PPL Electric was required to use the “flow-through” method to determine its recoverable income taxes for ratemaking purposes, thereby passing on to ratepayers the tax savings resulting from certain timing differences under federal and state tax laws.\textsuperscript{10} Relying on a doctrine established by the Pennsylvania Commonwealth Court, the PA PUC explained:

\begin{quote}
we are guided by the Internal Revenue Code and the “actual taxes paid” doctrine as enunciated by the commonwealth court. Where the code is
\end{quote}

\textsuperscript{8} See \textit{infra} nn.124 & 125.

\textsuperscript{9} \textit{Id.} at 5. PPL Electric served a few small wholesale customers through bundled power sales contracts, which included the cost of delivery. \textit{Id.}

silent on the treatment to be afforded a particular matter, we perceive our
duty to approximate the actual taxes to be paid by the utility, and pass that
cost, and only that cost, on to ratepayers.  

Because the Internal Revenue Code was silent with respect to the deferred tax benefits at
issue, the PA PUC found that generally it is improper to allow normalization and
determined that “flow through of such tax savings is consistent with the sound, long-
standing principle of reflecting in rates an allowance for a cost that is no greater than the
cost actually and prudently incurred by the utility.” Accordingly, PPL Electric’s
allowable income tax expense, which was flowed through to retail customers, was
reduced to reflect the benefits of various tax timing differences with the understanding
that once these timing differences reversed the resultant higher income tax expense would
be recovered from ratepayers.

On April 24, 1996, the Commission issued Order No. 888, which required
transmission owners to provide transmission service on open, non-discriminatory terms
and to unbundle wholesale transmission from generation. On December 31, 1996, PPL
Electric along with the other transmission owning members of PJM filed a series of
agreements to comprehensively restructure PJM to comply with Order No. 888’s open
access rules.

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11 PA PUC Flow-Through Order at *65 (citation omitted).
12 Id. at *66.
13 Kleha Testimony at 4-5.
14 Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission
Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting
1997), FERC Stats. & Regs. ¶ 31,048 (1997), order on reh’g, Order No. 888-B, 81 FERC ¶
61,248 (1997), order on reh’g, Order No. 888-C, 82 FERC ¶ 61,046 (1998), aff’d in relevant part
sub nom. Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), aff’d
15 Atl. City Elec. Co., et al., Compliance of the Pennsylvania-New Jersey-Maryland
(“December 31st PJM Filing”). Prior to the December 31st PJM Filing, a group of PJM
transmission owners, including PPL Electric, filed a proposal to restructure PJM and create PJM
as an independent system operator (“ISO”). Atl. City Elec. Co., et al., Restructuring of the
Pennsylvania-New Jersey-Maryland Interconnection, Docket Nos. ER96-2516-000, et al. (filed
Jul. 24, 1996). PECO Energy Company also filed a competing proposal. PECO Energy Co., In
ER96-2668-000, et al. (filed Aug. 8, 1996). However, the Commission rejected both proposals
for failure to comply with Order No. 888’s open access requirements and offered guidance on
how to form an acceptable ISO. Atl. City Elec. Co., et al., 77 FERC ¶ 61,148 (1996). The
December 31st PJM Filing was filed in response to that order.
Contemporaneous with the restructuring of PJM and unbundling of wholesale transmission rates pursuant to Order No. 888, the Commonwealth of Pennsylvania was undertaking its own restructuring effort to promote retail competition. Under Pennsylvania’s retail restructuring program, transmission and distribution delivery charges were unbundled from retail electricity sales. PPL Electric remained responsible for distribution, while either competitive retail suppliers (Electric Generation Suppliers or “EGSs”) or the default retail supplier (PPL Electric) became responsible for arranging for Network Integration Transmission Service used in serving PPL Electric’s retail distribution customers.

On September 30, 1997, while the December 31st PJM Filing was pending before the Commission, PPL Electric submitted a request to change its annual revenue requirement in order to harmonize the cost support and test period used in the PJM Tariff with the cost support and test period PPL Electric used in its retail restructuring proceeding before the PA PUC. To do so, PPL Electric relied upon a cost-of-service analysis that was submitted to the PA PUC for the projected test year consisting of the 12-month period ending September 30, 1995. Consistent with the PA PUC Flow-Through Order discussed above, PPL Electric’s cost-of-service filing relied upon the flow-through method for the treatment of tax savings resulting from tax timing differences.

On November 25, 1997, the Commission conditionally approved the December 31st PJM Filing and required transmission owners, including PPL Electric, to submit compliance filings in conformance with the Commission’s order. On February 17, 1998, the Commission accepted PPL Electric’s Revenue Requirement Filing, subject to refund, established hearing and settlement judge procedures, and consolidated the proceeding with the sub-docket created to address PPL Electric’s compliance filing required by the PJM Restructuring Order. In that consolidated proceeding, the

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18 Id. at 4 and Exhibit 3.
19 Kleha Testimony at 7.
Commission ultimately approved a “black box” settlement establishing a stated annual transmission service rate and revenue requirement for PPL Electric. The settlement did not address the calculation or treatment of the tax benefits of tax timing differences, which PPL Electric continued to accrue as a regulatory asset based on the flow-through method. Accordingly, PPL Electric continued to calculate its recoverable income tax expense in accordance with the PA PUC Flow-Through Order and record deferred income taxes as a regulatory asset.

In 2008, PPL Electric submitted a cost-of-service formula rate to establish the transmission revenue requirement for PPL Electric’s transmission assets under the PJM Tariff. The Commission accepted the formula rate to become effective November 1, 2008, subject to refund, and established hearing and settlement judge proceedings. The Commission issued an order approving an uncontested settlement agreement establishing PPL Electric’s transmission cost-of-service formula rate on August 21, 2009. When PPL Electric implemented its formula rate, it changed its transmission ratemaking methodology for recovery of income taxes, including tax savings that had previously been flowed through to ratepayers under the PA PUC Flow-Through Order, to full normalization of all tax timing differences. However, as described in detail below, the deferred tax liability that accrued as a result of flow-through ratemaking under the PA PUC Flow-Through Order prior to the implementation of PPL Electric’s formula rate will not be recovered through the formula rate’s full normalization ratemaking.

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24 Banzhoff Testimony at 5. See Section III, infra.
25 Id. at 5.
29 Kleha Testimony at 8. See also Formula Rate; 18 C.F.R. § 35.24.
30 Kleha Testimony at 8-9.
III. PPL ELECTRIC HAS PROPERLY ACCOUNTED FOR THE DEFERRED TAX LIABILITY.

A. PPL Electric Has Accounted For The Deferred Tax Liability Consistent With The Rules And Regulations Of The Commission, And The Internal Revenue Service.

From 1981 through 1992, PPL Electric recorded deferred income taxes in accordance with Accounting Principles Board Opinion No. 11 (“APB 11”), “Accounting for Income Taxes.” APB 11 used the deferred method, which placed emphasis on the income statement in that it was mostly concerned with the matching of revenues and expenses for the years in which those expenses and revenues were realized. Thus, during the 1981-1992 timeframe, and in accordance with the emphasis on the matching of revenues and expenses inherent in APB 11, PPL Electric did not record deferred income tax expense applicable to revenue items that received flow-through treatment in ratemaking.

In January 1993, PPL Electric adopted the Financial Accounting Standards Board’s (“FASB”) Statement of Accounting Standards No. 109 (“SFAS 109”). SFAS 109 required a change from the deferred method to the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred income tax assets and liabilities are recognized to reflect the tax consequences of temporary differences in the timing of recovery. SFAS 109 stated that regulated enterprises, such as PPL Electric, that meet the criteria for application of FASB Statement No. 71 (“SFAS 71”), “Accounting for the Effects of Certain Types of Regulation,” are not exempt from the requirements of SFAS 109. SFAS 71 indicated that, if, as a result of an action by a regulator, it is probable that the future increase or decrease in taxes payable will be recovered from or returned to customers through future rates, an asset or liability shall be recognized for that probable increase or reduction in future revenue and that asset or liability also shall be a temporary difference for which a deferred tax asset or liability shall be recognized.

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31 Banzhoff Testimony at 6.
33 Banzhoff Testimony at 6.
34 Id.
35 Id.
36 Id.
37 SFAS 109 at 29.
38 Id. Banzhoff Testimony at 7.
In compliance with SFAS 109, in January 1993, PPL Electric determined the tax benefits associated with production, distribution, and transmission assets that previously flowed through to customers and recorded an increase in its deferred tax liability in Accounts 190 and 283 to reflect that amount.\(^39\) PPL Electric also recorded an asset in Account 186 of the same amount to recognize the probable recovery of the future increased taxes recoverable through the ratemaking process, based on the established regulatory practices and legislative history in Pennsylvania as reflected in the \textit{PA PUC Flow-Through Order}.\(^40\)

In March 1993, the Commission issued \textit{Order No. 552}, Revisions to Uniform System of Accounts to Account for Allowances Under the Clean Air Act Amendments of 1990, which addressed accounting and reporting requirements for regulatory assets.\(^41\) Specifically, \textit{Order No. 552} created Account 182.3 to include costs incurred and charged to expense, which have been, or are soon expected to be, authorized for recovery through rates, and which are not specifically provided for in other accounts.\(^42\) In accordance with \textit{Order No. 552}, in November 1993, PPL Electric moved the balance of regulatory assets from Account 186 to Account 182.3, Other Regulatory Assets, including the deferred tax liability that had accrued under the \textit{PA PUC Flow-Through Order} and moved applicable deferred income taxes from Account 283 to Account 282, Accumulated Deferred Income Taxes-Other Property.\(^43\)

Once PPL Electric moved the balance of regulatory assets to Account 182.3, the annual changes in transmission-related deferred tax liability resulting from the \textit{PA PUC Flow-Through Order}, plus a tax gross-up to yield the total revenue that will be required when the timing differences reverse, were recorded in Account 182.3.\(^44\) However,

\(^{39}\) Banzhoff Testimony at 6-7.

\(^{40}\) \textit{Id.} at 7.


\(^{42}\) \textit{Id.} at pp. 30,825-26.

\(^{43}\) Banzhoff Testimony at 7-8. As described by Mr. Banzhoff, PPL Electric’s unfunded future tax liability is comprised of: (1) the state tax effect of timing differences related to book versus state tax method and life depreciation differences on all vintaged property; (2) the federal tax effect of the cumulative timing differences related to book versus federal tax method and life depreciation differences on vintaged property before the adoption of the Accelerated Cost Recovery System ("ACRS")/Modified Accelerated Cost Recovery System ("MACRS"); (3) the federal and state tax effects of capitalizing overheads prior to the adoption of the Tax Reform Act of 1986; (4) the federal and state tax effects of capitalizing overheads subsequent to the adoption of the Tax Reform Act of 1986; and (5) the federal and state tax effects of timing differences related to the book versus tax treatment of cost of removal and salvage. \textit{Id.} at 8-9.

\(^{44}\) \textit{Id.} at 8.
amounts recorded in Account 182.3 and reported in FERC Form No. 1 are aggregated to include regulatory assets related to distribution, transmission, general, and intangible plant. In order to determine the precise amount of unfunded transmission-related tax liability recorded in Account 182.3 as of the time PPL Electric switched to full normalization upon the implementation of its formula transmission rate on November 1, 2008, PPL Electric conducted a computation using the South Georgia Method.\footnote{Id. at 11-12.}

**B. PPL Electric Has Properly Accounted For The Deferred Tax Liability To Be Recovered From Ratepayers Consistent With The South Georgia Method.**

PPL Electric’s South Georgia computation and derivation of PPL Electric’s unfunded transmission-related tax liability that resulted from the transition from flow-through to full normalization (“Transmission Regulatory Asset To Be Recovered”) are presented in Exhibit Nos. PPL-101 through PPL-103 to Mr. Banzhoff’s testimony. The South Georgia computation performed by PPL Electric consists of the following three basic steps that are explained in detail below and in Mr. Banzhoff’s testimony:

- **Step One:** Determine the tax impact of the difference between book and tax basis calculated using full normalization as of the date of conversion to the normalization under the formula rate (“Total Future Deferred Tax Liabilities”).\footnote{Id. at 13. Step One is shown on Lines 1 through 18 of Exhibit No. PPL-101.}

- **Step Two:** Determine the deferred taxes recorded in Accounts 190 and 282 under the PA PUC Flow-Through Order in place just prior to the conversion to full normalization under the formula rate (“Deferred Taxes Recorded Under Flow-Through”).\footnote{Banzhoff Testimony at 13. Step Two is shown on Line 19 of Exhibit No. PPL-101.}

- **Step Three:** Subtract the Deferred Taxes Recorded Under Flow-Through from the Total Future Deferred Tax Liabilities to determine the deferred tax difference between normalization and flow-through, and add a tax component to account for the fact that the additional revenue required to recover the additional tax expense will be taxed as income (“Taxes Recoverable Through Future Rates”).\footnote{Banzhoff Testimony at 13. Step Three is shown on Lines 20 through 23 of Exhibit No. PPL-101.}

These three steps are presented in Exhibit No. PPL-101 to Mr. Banzhoff’s testimony for all of the functions of PPL Electric. Line 23, column b, of Exhibit No.
PPL-101 is the amount recorded in Account 182.3, “Taxes Recoverable Through Future Rates” and reported in PPL Electric’s 2008 FERC Form No. 1 at page 232, line 1, column f. However, because Taxes Recoverable Through Future Rates includes deferred income taxes attributable to all of the functions of PPL Electric, Mr. Banzhoff also shows in Exhibit No. PPL-101 the functional assignment of the total amounts to transmission, general and intangible (“G&I”), and distribution.\(^\text{49}\) As Mr. Banzhoff explains, the assignment to transmission, G&I, and distribution was done using detailed information reported by PPL Electric’s tax depreciation and deferred tax software, PowerTax.\(^\text{50}\) PowerTax is a widely used and trusted tax software system that PPL Electric uses to compute, record, and track the tax treatment of its plant assets and related deferred taxes.\(^\text{51}\) All of the amounts derived from PowerTax that are used in the South Georgia computation are based on amounts recorded by PPL Electric pursuant to the Uniform System of Accounts.\(^\text{52}\)

The results of the South Georgia computation on Line 23 of Exhibit No. PPL-101 show that the transmission component of Taxes Recoverable Through Future Rates and the G&I component of Taxes Recoverable Through Future Rates are $51,439,409 and $18,806,280, respectively. Because only a portion of G&I plant is attributable to PPL Electric’s FPA jurisdictional transmission business, on Line 4 of Exhibit No. PPL-103, Mr. Banzhoff functionalizes a portion of the G&I component of Taxes Recoverable Through Future Rates to transmission using a wages and salary allocator.\(^\text{53}\) On Line 5 of Exhibit No. PPL-103, the transmission component of Taxes Recoverable Through Future Rates is combined with the functionalized G&I component to determine the Transmission Regulatory Asset To Be Recovered.\(^\text{54}\)

The inputs used for PPL Electric’s South Georgia computation are the same inputs utilized by PPL Electric in its December 2008 calculation of its regulatory asset “Taxes Recoverable Through Future Rates” and reported in PPL Electric’s 2008 FERC Form No. 1 at page 232, line 1, column f, which are based on amounts that were recorded

\(^{49}\) Banzhoff Testimony at 13-14. A portion of Taxes Recoverable Through Future Rates also is based on pending audit adjustments shown in columns i and j of Exhibit No. PPL-101. \(\text{Id.}\) at 14.

\(^{50}\) \(\text{Id.}\) at 14.

\(^{51}\) \(\text{Id.}\) Pacific Gas & Electric Company (“PG&E”) relied on data reported by PowerTax to support the South Georgia Method adjustment it proposed to include in its stated rate. \(\text{Pac. Gas & Elec. Co.},\) General Rate Case Pacific Gas and Electric Company Transmission Owner Tariff Rate Filing, Docket No. ER10-2026-000, Exhibit PGE-30 at 312 (filed July 28, 2010). \text{See also Pac. Gas & Elec. Co.}, 132 FERC \& 61,272 (2010) (accepting and suspending tariff changes and establishing hearing and settlement procedures); \(\text{Pac. Gas & Elec. Co.},\) 136 FERC \& 61,095 (2011) (accepting settlement offer).

\(^{52}\) Banzhoff Testimony at 14.

\(^{53}\) \(\text{Id.}\) at 21.

\(^{54}\) \(\text{Id.}\) at 21-22.
pursuant to the Uniform System of Accounts. These inputs were used to calculate year-end deferred tax amounts that were reported by PPL Electric in its 2008 FERC Form No. 1 and the accumulated deferred income taxes used in PPL Electric’s formula rate. Mr. Banzhoff explains that in accordance with PPL Electric’s standard accounting procedures, year-end deferred tax accruals that are reported in the FERC Form No. 1 are calculated based on ten months of actual data and two months of estimated data. This data is based on company records that are maintained pursuant to the Uniform System of Accounts and reported by PPL Electric’s tax depreciation and deferred tax software, PowerTax. For this reason, the book balance and reserve amounts used in the South Georgia computation shown in Exhibit No. PPL-101 do not directly correspond with the plant book and reserve amounts reported in the 2008 FERC Form No. 1, which are based on a full twelve months of actual costs.

PPL Electric relied upon 2008 data because PPL Electric’s formula rate was implemented in 2008. Also, PPL Electric’s accounting for timing differences continued to reflect the application of the PA PUC Flow-Through Order throughout 2008, even though PPL Electric’s conversion to a full normalization ratemaking methodology became effective on November 1, 2008 with the implementation of its formula rate. The use of the 2008 data also is consistent with the method used to allocate a portion of the G&I component to transmission as shown in Exhibit No. PPL-103. As Mr. Banzhoff explains, to functionalize the appropriate amount of the G&I component to

55 Id. at 15.
56 Id.
57 Id.
58 Id. at 14.
59 Id. at 16.
60 Id. Order Accepting Formula Rate at P 1.
61 Banzhoff Testimony at 9-11. Although full normalization of income taxes is reflected in PPL Electric’s formula rate template, PPL Electric did not make a corresponding change in its accounting when the formula rate became effective. Id. at 9. In 2011, PPL Electric identified the mismatch between its accounting and ratemaking methodologies, which led to the identification of PPL Electric’s unfunded deferred tax liability that it is seeking to recover in this filing. Id. at 9-10. In 2011, PPL Electric made the appropriate adjustments to its accounting practices and deferred tax expense recorded in its accounts to reflect normalization. Id. at 10. These changes are described by Mr. Kleha explains, the accounting changes have an extremely small effect on the transmission rates computed under PPL Electric’s formula rate for the 2008 through 2010 rate years. Kleha Testimony at 14-15. As part of its 2012 formula rate update, PPL Electric will address the impact of the accounting changes on the formula rate data inputs from these years and refund any overcharges as appropriate. Id. at 15-16.
62 Banzhoff Testimony at 16-17.
transmission, he used the wages and salaries allocator from the true-up of the formula rate to 2008 FERC Form No. 1 data that was posted as part of the 2009 formula rate annual update.63

The calculation of Step One of the South Georgia computation is shown on Lines 1 through 18 of Exhibit No. PPL-101.64 As explained above and in Mr. Banzhoff’s testimony, the book balance and reserve amounts shown on Lines 4, 5, 11, and 12 of Exhibit No. PPL-101, as well as the tax balance and reserve amounts shown on Lines 1, 2, 8, and 9, are reported by PowerTax.65 After determining the federal and state basis differences on Lines 1 through 14, the differences are multiplied by the currently effective federal and state tax rate to determine the amount of future federal and state tax liability, respectively.66 The combined future federal and state tax liability, with an adjustment for the deductibility of state taxes from federal taxable income, represents Total Future Deferred Tax Liabilities on Line 18.67

Step Two of the South Georgia computation, the Deferred Taxes Recorded Under Flow-Through, is shown on Line 19 of Exhibit No. PPL-101.68 The inputs to Deferred Taxes Recorded Under Flow-Through from Account 190, Accumulated Deferred Income Taxes, and Account 282, Accumulated Deferred Income Taxes—Other Property, are taken from Attachment 1 to PPL Electric’s 2009 formula rate annual update. The Deferred Taxes Recorded Under Flow-Through related to transmission consist of ACRS and MACRS less net basis adjustments and tax-related contributions in aid of construction (“CIAC”) recorded in Account 190.69 The Account 190 tax-related CIAC offsets the deferred taxes recorded on taxable CIAC at federal and state statutory income tax rates.70 Therefore, the amount of the regulatory asset for taxes recoverable that is related to CIAC is zero.71 The Deferred Taxes Recorded Under Flow-Through related to G&I also consist of ACRS and MACRS less net basis adjustments.72 These amounts are shown in Exhibit No. PPL-102.

64 Banzhoff Testimony at 17.
65 Id. at 17.
66 Id.
67 Id. at 17-18.
68 Id. at 18.
69 Id. at 19.
70 Id.
71 Id.
72 Id.
The results of Step Three of the *South Georgia* computation are shown on Lines 20 through 23 of Exhibit No. PPL-101.\textsuperscript{73} Line 20 shows the difference between the Total Future Deferred Tax Liabilities in Step One and the Deferred Taxes Recorded Under Flow-Through in Step Two.\textsuperscript{74} Line 22 shows the Tax Gross-up amount that must be added because, upon recovery of the regulatory asset, the amount becomes taxable income.\textsuperscript{75} As Mr. Banzhoff explains, the Tax Gross-up was calculated using currently effective tax rates.\textsuperscript{76} Finally, Line 23 shows the Taxes Recoverable Through Future Rates.\textsuperscript{77}

Only the transmission component and a functionalized G&I component of Taxes Recoverable Through Future Rates in Exhibit No. PPL-101 contribute to the Transmission Regulatory Asset To Be Recovered that is the subject of this filing.\textsuperscript{78} Thus, a further calculation, as shown in Exhibit No. PPL-103 to Mr. Banzhoff’s testimony, is required to determine the functionalized G&I component.\textsuperscript{79} The functionalized G&I component then is added to the transmission component to determine the Transmission Regulatory Asset To Be Recovered of $53,338,260.\textsuperscript{80} This $53.3 million was recorded in Account 182.3 and represents the tax benefit flowed through to customers that would have been recovered through transmission rates in later years, if PPL Electric continued to use flow-through ratemaking under the PA PUC’s flow-through policy.\textsuperscript{81} However, as a result of the conversion to full normalization ratemaking in the formula rate template in accordance with the Commission’s policies, this Transmission Regulatory Asset To Be Recovered is an unfunded deferred tax liability that, absent an order from the Commission approving the *South Georgia* recovery proposed herein, will be trapped.\textsuperscript{82}

Consistent with the *South Georgia* Method, once the Transmission Regulatory Asset To Be Recovered is determined, it is amortized over a fixed period equivalent to

\textsuperscript{73} *Id.*
\textsuperscript{74} *Id.*
\textsuperscript{75} *Id.* at 20
\textsuperscript{76} *Id.* at 20. The use of currently effective tax rates, rather than rates in effect when the unfunded tax liability was accumulated, is appropriate because the additional taxable income that will be realized will be taxed at the rate in effect at the time. *Id.* This also would have been the case had PPL Electric continued under the *PA PUC Flow-Through Order* as the timing differences reversed. *Id.* Because future rates are unknown at this time, the currently effective tax rates are the only reasonable proxy. *Id.*
\textsuperscript{77} *Id.*
\textsuperscript{78} *Id.* at 20.
\textsuperscript{79} *Id.* at 21.
\textsuperscript{80} *Id.* at 21-22.
\textsuperscript{81} *Id.* at 22.
\textsuperscript{82} Kleha Testimony at 9.
the remaining useful life of the assets which generated the tax timing differences. Although PPL Electric’s unfunded tax liability was calculated using transmission, as well as an allocated share of G&I plant, PPL Electric is proposing to use only the longer-lived transmission assets to determine the amortization period. As Mr. Kleha explains, the amortization period was calculated by dividing the net transmission plant in service at the time PPL Electric’s transmission formula rate was implemented in 2008 by PPL Electric’s 2008 transmission depreciation expense. The result was rounded up to 34 years. This yielded an annual recovery of $1,568,772 (“Annual Amortized Regulatory Asset To Be Recovered”) and a monthly charge of $130,731 (“Monthly Amortized Regulatory Asset To Be Recovered”). The Monthly Amortized Regulatory Asset To Be Recovered will be allocated to each network service customer serving PPL Electric’s retail distribution customers pursuant to the revised Attachment H-8A, described below in Section IV.

IV. DESCRIPTION OF THE PROPOSED REVISIONS TO ATTACHMENT H-8A OF THE PJM TARIFF

PPL Electric is proposing to revise Attachment H-8A of the PJM Tariff to incorporate a Monthly Deferred Tax Adjustment Charge. Attachment H-8A currently recovers the costs of serving certain municipal and cooperative customers within the PPL Zone at distribution level voltages, which are not included in PPL Electric’s formula rate. The Monthly Deferred Tax Adjustment Charge would similarly recover costs not included in the formula rate. The proposed charge by its terms is limited to network service customers that serve one or more customers taking distribution service from PPL Electric. As noted earlier, although Pennsylvania has implemented retail electric competition, under its PA PUC tariff, PPL Electric remains responsible for providing distribution service to all retail customers in its service area. EGSs and PPL Electric, in its role as a default electric generation supplier to its non-shopping distribution

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83 Id. at 11-12.
84 Id. at 12.
85 Id. The 2008 depreciation expense was based on a depreciation study that had been submitted to and approved by the PA PUC in 2008, and was used to establish the final depreciation rates for the initial 7-month period of PPL Electric’s formula rate. Id. See also Formula Rate Settlement Order.
86 See Exhibit No. PPL-201 at Line 5.
87 Id. at Lines 7-8; Kleha Testimony at 13.
88 Kleha Testimony at 13.
89 PPL Electric’s transmission plant includes facilities at 69 kV and higher voltages. Id. at 14.
90 Kleha Testimony at 10.
91 Id. at 6.
customers, are subject to the charge. Wholesale customers, who, as discussed below, were not beneficiaries of the PA PUC’s policies requiring the flow-through of tax benefits, are not covered by the charge.

The Monthly Deferred Tax Adjustment Charge is a fixed monthly demand charge. In accordance with the proposed revisions to Attachment H-8A, the Monthly Deferred Tax Adjustment Charge is determined by allocating the Monthly Amortized Regulatory Asset To Be Recovered among customers in the same manner as monthly network service charges are allocated under Section 34.1 of the PJM Tariff, with the exception that the Monthly Amortized Regulatory Asset To Be Recovered is allocated only among network service customers serving PPL Electric’s distribution customers rather than all customers in the PPL Zone. The Monthly Deferred Tax Adjustment Charge is determined by multiplying the Monthly Amortized Regulatory Asset To Be Recovered by the applicable individual network service customer’s annual peak load (net of behind the meter generation) divided by the coincident peak load of all network service customers servicing PPL Electric’s distribution customers. Because the shares and peak load are adjusted annually, neither load growth (nor decline) will affect PPL Electric’s recovery, and it will recover only the stated Annual Amortized Regulatory Asset To Be Recovered each year.

V. RECOVERY OF PPL ELECTRIC’S DEFERRED TAX LIABILITY IS JUST AND REASONABLE AND CONSISTENT WITH COMMISSION PRECEDENT.

The Uniform System of Accounts defines “regulatory assets” as assets “that result from rate actions of regulatory agencies” and “arise from specific revenues, expenses, gains, or losses that would have been included in net income determination in one period under the general requirements of the Uniform System of Accounts but for it being probable . . . that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services.” The $53.3 million, as described above and in Mr. Banzhoff’s testimony, was properly recorded and represents a valid deferred cost created due to the timing differences in the recognition of income as a result of the switch from the flow-through method under the PA PUC Flow-Through Order to full normalization in accordance with Commission regulation. As such, the $53.3 million is a valid regulatory asset and, as described below,  

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92 Id. at 10.
93 Id. at 11.
94 Id. at 9.
95 Id. at 13.
96 Id.
97 Id.
recovery of this regulatory asset is just and reasonable, and consistent with Commission precedent.


Pursuant to the basic principles of ratemaking, PPL Electric is entitled to fully recover the costs it prudently incurs in providing transmission service, including income taxes.99 From 1981 through 1997, almost all of PPL Electric’s transmission revenue requirement was collected through bundled retail rates approved by the PA PUC, which included the cost of transmission service.100 As described above, the PA PUC’s ratemaking policy required flow-through treatment of tax savings resulting from timing differences to reflect actual taxes paid.101 Thus, as a result of relying upon the PA PUC’s flow-through ratemaking methodology, PPL Electric’s transmission rates for retail customers included a lower tax expense than would have otherwise been included under a full normalization ratemaking methodology with the expectation that offsetting higher tax expenses would be recovered in later periods.102

The remaining portion of PPL Electric’s transmission revenue requirement was collected from wholesale customers served pursuant to Commission jurisdictional bundled contracts.103 The Commission-jurisdictional wholesale contracts employed normalized treatment of both state and federal income taxes, consistent with the Commission’s ratemaking methodology.104

When PPL Electric’s transmission rates were unbundled to comply with Order No. 888 in 1997, PPL Electric proposed a transmission revenue requirement based on the cost unbundling study and time period used in its concurrent restructuring proceeding before the PA PUC.105 That cost study relied upon the flow-through method for

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99 Pub. Sys. v. FERC, 709 F.2d 73 (D.C. Cir. 1983) (“The rates [of public utilities under the FPA] are based on cost of service, which comprises ‘all expenses incurred, including income taxes, plus a reasonable return on capital.’” (citing Pub. Serv. Co. v. FERC, 653 F.2d 681, 683 (D.C. Cir. 1981))).

100 Kleha Testimony at 5.

101 PA PUC Flow-Through Order at *63-68.

102 Kleha Testimony at 4-5.


104 Kleha Testimony at 11.

105 Revenue Requirement Filing at 4 and Exhibit 3.
determining recoverable income taxes in accordance with the *PA PUC Flow-Through Order*.\textsuperscript{106} Thus, from 1997 through 2008, PPL Electric’s transmission ratemaking continued to be based upon the flow-through method of recovering tax expense, and deferred tax liability continued to accrue.\textsuperscript{107}

In 2008, the implementation of PPL Electric’s formula rate resulted in a conversion of PPL Electric’s transmission ratemaking to full normalization.\textsuperscript{108} Under fully normalized ratemaking, the deferred tax liability, which accrued as a result of the *PA PUC Flow-Through Order*, is unfunded because the offsetting higher tax expenses in later periods will not be flowed through.\textsuperscript{109} Therefore, without an adjustment, the reversal of the timing differences will result in PPL Electric’s network service rates underrecovering its incurred income tax expense.\textsuperscript{110} PPL Electric’s transmission formula rate does not provide a mechanism to make the necessary adjustment to allow PPL Electric to address the shortfall in revenue required to fund its deferred tax liabilities that are trapped as a result of the switch from flow-through treatment to full normalization.\textsuperscript{111} Therefore, PPL Electric proposes to include a *South Georgia* Method adjustment in Attachment H-8A of the PJM Tariff.\textsuperscript{112}

The adjustment only applies to network customers serving retail distribution customers of PPL Electric, because PPL Electric’s pre-Order No. 888 bundled wholesale customers were served under Commission jurisdictional tariffs.\textsuperscript{113} The rates in those tariffs would have been determined under the Commission’s regulations and *Order No. 144*, which requires full normalization.\textsuperscript{114} Thus, PPL Electric’s income tax expense included in those tariff rates would have been recovered using normalization in accordance with Commission regulation.\textsuperscript{115} Network transmission customers not serving PPL Electric’s retail distribution customers, but taking network service from PJM over PPL Electric’s transmission facilities, did receive the benefit of the PA PUC’s flow-through policy between 1998 and 2008; however, PPL Electric did not record any future tax liability in connection with the *PA PUC Flow-Through Order* with respect to these

\textsuperscript{106} Kleha Testimony at 7.

\textsuperscript{107} Id. at 7-8.

\textsuperscript{108} Id. at 8.

\textsuperscript{109} Id. at 9.

\textsuperscript{110} Id.

\textsuperscript{111} Id.

\textsuperscript{112} Id. at 9-12.

\textsuperscript{113} Id. at 10-11.

\textsuperscript{114} Id. at 11.

\textsuperscript{115} Id.
Accordingly, PPL Electric is not seeking any recovery of its unfunded tax liability from such transmission customers.\(^{117}\)

### B. PPL Electric’s Recovery Of Its Deferred Tax Liability Using The South Georgia Method Is Consistent With Commission Precedent.

In *Order No. 144*, the Commission recognized that the switch from flow-through to normalization creates timing differences that may result in deferred tax reserves which are “deficient from that required to provide for the associated future tax liabilities as they arise.”\(^{118}\) Accordingly, the Commission found that it is appropriate for “companies to make some provision in their deferred taxes for the tax effects of timing difference transactions that had previously been flowed through.”\(^{119}\) The Court of Appeals upheld the Commission’s decision to allow companies to use a “make-up provision” to recover past timing difference transactions that were given flow-through treatment.\(^{120}\) The court found that a “make-up provision” is reasonable and is not retroactive ratemaking because the provision does not adjust for shortfalls in prior rates. It only adjusts future rates so that tax costs will not fall disproportionately on one ratepayer generation. Ratepayers are not charged for a greater tax allowance under the provision than they otherwise would be; they merely incur the cost over a different time period.\(^{121}\)

In *Order No. 144*, the Commission declined to endorse a specific methodology to implement this mechanism because it had not analyzed a generic ratemaking method that would accomplish the objective of full normalization as part of its rulemaking process. Instead, the Commission opted to review proposals on a case-by-case basis.\(^{122}\) According to the Commission, “[a]s the issue is resolved in a number of cases, one or more specific methods (e.g., the ‘South Georgia Method’) that would have wide applicability may be adopted.”\(^{123}\)

\(^{116}\) *Id.*  
\(^{117}\) *Id.*  
\(^{118}\) *Order No. 144* at p. 31,559.  
\(^{119}\) *Id.*  
\(^{120}\) *Pub. Sys. v. FERC*, 709 F.2d 73, 84-85 (D.C. Cir. 1983).  
\(^{121}\) *Id.* at 85. *See also Town of Norwood v. FERC*, 53 F.3d 377, 381 (D.C. Cir. 1995) (noting that the court has upheld the *Order No. 144* make-up provision “against charges of retroactive ratemaking on the grounds that ‘past’ costs collected during the transition were costs that the utility had always planned to charge to future ratepayers”).  
\(^{122}\) *See* 18 C.F.R. § 35.24(c)(3).  
\(^{123}\) *Order No. 144* at p. 31,560 (citation omitted).
Although no specific method was approved by the Commission in Order No. 144, the South Georgia Method was specifically identified and the Commission has, on several occasions, approved transmission rates that relied upon the South Georgia Method to determine an appropriate catch-up adjustment amount for deferred taxes following a switch from flow-through treatment to tax normalization. For example, the Commission approved San Diego Gas & Electric Company’s (“SDG&E”) settlement agreement that implemented a transmission formula rate and included a South Georgia Method adjustment for retail rates to account for the tax benefits that previously flowed through to retail customers. The Commission also has approved PG&E’s stated rate filings that incorporate a South Georgia Method adjustment to account for the timing differences between flow-through treatment and full normalization.

In general, under the South Georgia Method, the unfunded future tax liability is amortized over the average remaining useful life of the property. The South Georgia Method adjustment that PPL Electric proposes to use to recover its unfunded deferred tax liability is consistent with the Commission’s decision in Order No. 144 to permit “make-up” provisions to account for the tax benefits which previously were flowed through to retail customers. PPL Electric seeks to recover no more than it would have recovered had it continued to use the flow-through ratemaking methodology. As explained in Section III above and in Mr. Banzhoff’s testimony, PPL Electric continuously has recorded the Transmission Regulatory Asset To Be Recovered pursuant to the Uniform System of Accounts and, if PPL Electric continued to use the flow-through ratemaking methodology, this amount would have been recovered as the tax benefits were exhausted and the resultant higher income taxes were flowed through to ratepayers. However, as a result of PPL Electric’s switch from flow-through to normalization, this will not occur, and PPL Electric will pay more in income tax than it recovers from ratepayers. As such, the South Georgia Method adjustment that PPL Electric proposes is necessary to account for the timing differences between flow-through and normalization, and is consistent with the Court of Appeals’ decision permitting “make-up” provisions. PPL Electric’s proposed South Georgia Method adjustment also is consistent with other transmission rates that the Commission has approved for other public utilities that faced similar transitions from state flow-through ratemaking to full normalization under the Commission’s policies.


125 See, e.g., Pac. Gas & Elec. Co., Transmission Owner Tariff Rate Filing, Docket No. ER06-1325-000 at Exhibit PGE-11 (filed Aug. 1, 2006) (filing to request increase to stated rate that included an adjustment to estimated income taxes to account for timing differences created by the change from flow-through to normalization); Pac. Gas & Elec. Co., 119 FERC ¶ 61,247 (2007) (approving uncontested settlement agreement).

126 HERNAN GONZALEZ & WILLIAM ARTHUR ERKEN, TAXATION OF PUBLIC UTILITIES § 8.08 (Lexis Nexis Matthew Bender) (1993).
VI. CONTENTS OF FILING

In addition to this transmittal letter, the filing consists of the following materials:

Attachment A: Revisions to Attachment H-8A of the PJM Tariff (Redlined format);

Attachment B: Revisions to Attachment H-8A of the PJM Tariff (Non-redlined format);

Attachment C: Prepared Direct Testimony of Gary L. Banzhoff (Exhibit Nos. PPL-100 through PPL-103); and

Attachment D: Prepared Direct Testimony of Joseph M. Kleha (Exhibit Nos. PPL-200 through PPL-201).

VII. REQUEST FOR WAIVERS

PPL Electric requests waiver of the following sections of the Commission’s regulations: Section 35.13(d)(1)-(2), 18 C.F.R. § 35.13(d)(1)-(2) (requiring submission of Period I and Period II data for Statements AA through BL); Section 35.13(d)(5), 18 C.F.R. § 35.13(d)(5) (requiring the submission of workpapers related to Period I and Period II data); and Section 35.13(h), 18 C.F.R. § 35.13(h) (requiring cost of service statements). Detailed statements on PPL Electric’s costs of service are unnecessary because the proposed charge is based on costs reflected in PPL Electric’s FERC Form No. 1, and detailed evidence regarding the calculation of the cost to be recovered and the proposed charge is submitted with this transmittal letter. To the extent any additional waivers are necessary to accept this filing, PPL Electric respectfully requests such waivers.

In accordance with Section 35.13(b) of the Commission’s regulations, 18 C.F.R. § 35.13(b), PPL Electric represents that: (1) no additional agreement, by contract or otherwise, is required for the filing of this rate; and (2) there are no expenses or costs included in this filing that have been alleged or judged in any administrative or judicial proceeding to be illegal, duplicative, or unnecessary costs that are demonstrably the product of discriminatory employment practices, within the meaning of Section 35.13(b)(7) of the Commission’s regulations.127

VIII. REQUESTED EFFECTIVE DATE

PPL Electric requests that the revised PJM Tariff sheets be made effective June 1, 2012 without modification, suspension or a hearing.

127 See 18 C.F.R. § 35.13(b)(7).
IX. PERSONS ON WHOM THIS FILING IS BEING SERVED

PJM has served a copy of this filing on all PJM Members and on all state utility regulatory commissions in the PJM Region by posting this filing electronically. In accordance with the Commission’s regulations, PJM will post a copy of this filing to the FERC filings section of its internet site, located at the following link: http://www.pjm.com/documents/ferc-manuals/ferc-filings.aspx with a specific link to the newly-filed document, and will send an e-mail on the same date as this filing to all PJM Members and all state utility regulatory commissions in the PJM Region alerting them that this filing has been made by PJM and is available by following such link. PJM also serves the parties listed on the Commission’s official service list for this docket. If the document is not immediately available by using the referenced link, the document will be available through the referenced link within 24 hours of the filing. Also, a copy of this filing will be available on the Commission’s eLibrary website located at the following link: http://www.ferc.gov/docs-filing/elibrary.asp in accordance with the Commission’s regulations and Order No. 714.

X. COMMUNICATIONS

Please direct all communications and service relating to this filing to the following individuals:

Paul E. Russell  
PPL Services Corporation  
Two North Ninth Street  
Allentown, PA 18101  
Phone: (610) 774-4254  
Fax: (610) 774-6726  
E-mail: perussell@pplweb.com

Donald A. Kaplan  
William M. Keyser  
Molly Suda  
K&L Gates LLP  
1601 K Street, N.W.  
Washington, DC 20006  
Phone: (202) 778-9000  
Fax: (202) 778-9100  
E-mail: don.kaplan@klgates.com  
william.keyser@klgates.com  
molly.suda@klgates.com

128 See id. §§ 35.2(e) and 385.2010(f)(3).

129 PJM already maintains, updates and regularly uses e-mail lists for all PJM Members and affected state commissions.
XI. CONCLUSION

For the reasons discussed above, PPL Electric respectfully requests that the Commission accept for filing the proposed revisions to Attachment H-8A to the PJM Tariff to be effective June 1, 2012 without condition, modification, or a hearing.

Respectfully submitted,

/s/ Donald A. Kaplan

Paul E. Russell
PPL Services Corporation
Two North Ninth Street
Allentown, PA 18101

Donald A. Kaplan
William M. Keyser
Molly Suda
K&L Gates LLP
1601 K Street, N.W.
Washington, DC 20006

Attorneys for PPL Electric Utilities Corporation
ATTACHMENT A
<table>
<thead>
<tr>
<th>Customer Rate</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allegheny Electric Cooperative</td>
<td>$2,583.33</td>
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<tr>
<td>Blakely</td>
<td>$3,850.29</td>
</tr>
<tr>
<td>Catawissa</td>
<td>$5,166.67</td>
</tr>
<tr>
<td>Duncannon</td>
<td>$1,194.57</td>
</tr>
<tr>
<td>Hatfield</td>
<td>$2,317.55</td>
</tr>
<tr>
<td>Olyphant</td>
<td>$5,203.23</td>
</tr>
<tr>
<td>St. Clair</td>
<td>$4,669.00</td>
</tr>
<tr>
<td>Watsontown</td>
<td>$1,588.48</td>
</tr>
</tbody>
</table>

**Monthly Deferred Tax Adjustment Charge**

Each Network Customer that serves one or more end-use customers taking distribution service from PPL Electric Utilities Corporation under its applicable retail tariff on file with the Pennsylvania Public Utility Commission (“PPL Electric Distribution Customers”) shall pay a Monthly Deferred Tax Adjustment Charge. The Monthly Deferred Tax Adjustment Charge shall be determined as follows:

\[
MDTAC = \frac{130,731 \times DCPL}{SDCPL}
\]

Where:

\[
MDTAC = \text{the Monthly Deferred Tax Adjustment Charge}
\]

\[
DCPL = \text{the daily load of the PPL Electric Distribution Customers served by the Network Customer coincident with the annual peak of the PPL Zone (as adjusted pursuant to Section 34.2 of the PJM Tariff)}
\]
$SDCPL = \text{the sum of the daily loads of all PPL Electric Distribution Customers coincident with the annual peak of the PPL Zone (as adjusted pursuant to Section 34.2 of the PJM Tariff)}$
ATTACHMENT B
ATTACHMENT H-8A

Other Supporting Facilities and Deferred Tax Adjustment Charges –
PPL Electric Utilities Corporation

Monthly Rates for Service to
Certain Pennsylvania Municipal Utilities and Cooperatives
Utilizing Facilities at Voltage Levels Below 69 kV

Customer Rate

<table>
<thead>
<tr>
<th>Customer</th>
<th>Rate</th>
</tr>
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<tbody>
<tr>
<td>Allegheny Electric Cooperative, Inc.</td>
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</table>

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Each Network Customer that serves one or more end-use customers taking distribution service from PPL Electric Utilities Corporation under its applicable retail tariff on file with the Pennsylvania Public Utility Commission ("PPL Electric Distribution Customers") shall pay a Monthly Deferred Tax Adjustment Charge. The Monthly Deferred Tax Adjustment Charge shall be determined as follows:

\[
MDTAC = 130,731 \times \frac{DCPL}{SDCPL}
\]

Where:

MDTAC = the Monthly Deferred Tax Adjustment Charge

DCPL = the daily load of the PPL Electric Distribution Customers served by the Network Customer coincident with the annual peak of the PPL Zone (as adjusted pursuant to Section 34.2 of the PJM Tariff)
SDCPL = the sum of the daily loads of all PPL Electric Distribution Customers coincident with the annual peak of the PPL Zone (as adjusted pursuant to Section 34.2 of the PJM Tariff)
ATTACHMENT C
UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

) )
PPL Electric Utilities Corporation ) Docket No. ER12-___-000
) )

PREPARED DIRECT TESTIMONY

OF

GARY L. BANZHOFF
ON BEHALF OF PPL ELECTRIC UTILITIES CORPORATION
Q. PLEASE STATE YOUR FULL NAME AND BUSINESS ADDRESS.

A. My name is Gary L. Banzhoff. My business address is Two North Ninth Street, Allentown, Pennsylvania 18101.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by PPL Electric Utilities Corporation (“PPL Electric”) as Controller. I assumed this position in September 2011.

Q. WHAT ARE YOUR DUTIES AS CONTROLLER?

A. I am responsible for PPL Electric’s regulatory accounting, regulatory reporting, financial analysis and business planning.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I received a Bachelor’s Degree in Business and Economics from Lehigh University in May 1975 and a Master of Business Administration Degree from Lehigh University in January 1983.
Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I began my employment with PPL Electric, then known as Pennsylvania Power & Light Company, in September 1975 as an Accountant in the Financial Planning and Reporting Department. I remained in that position for eight years and progressed to the position of Senior Accountant. My responsibilities included the completion and filing of various financial reports, including the Annual Report to Shareowners, Forms 10-K and 10-Q for the Securities and Exchange Commission and the FERC Form No. 1. In 1983, I transferred to General Accounting where I subsequently was promoted to Accounting Analyst and Supervisor – General Accounting. In General Accounting, I was responsible for the maintenance and closing of PPL Electric’s books and records and accounting research. In April 1991, I was promoted to the position of Manager-Financial Administration where I was responsible for the budgeting and administrative activities of the Financial Department. In October 1993, I assumed the position of Continuous Improvement Manager-Financial where I was responsible for implementing and tracking the total quality management activities of the Financial Department. In January 1995, I was promoted to Manager – Compensation in the Human Resources Department. In March 1998, I transferred to the Retail Energy Services Group as Manager – Development, where I was responsible for the human resources activities of that group. In December 1998, I assumed the position of Director-Business Services in the Energy Services Group, where I was responsible for the budgeting and financial reporting for the group. In May 2003, I was promoted to Controller – PPL Energy Services, where I was responsible for
budgeting, accounting, financial reporting, and administration of Mechanical
Contracting and Renewable Energy groups. In August 2006, I assumed the
position of Financial Director-Energy Services Group. In this position, I was
responsible for the budgeting, accounting, and financial reporting for the
Mechanical Contracting, Renewable Energy and Development groups. In June
2008, I assumed the position of Director – PA Delivery Accounting. In this
position, I was responsible for PPL Electric’s accounting, including the recording
of financial transactions in accordance with generally accepted accounting
principles and regulatory requirements, and for the preparation of regulatory
financial reports. In September 2010, I assumed the position of Director-Supply
Accounting and Reporting. In this position, I was responsible for PPL Energy
Supply’s accounting and reporting, including the recording and reporting of
financial transactions in accordance with generally accepted accounting
principles. In March 2011, I assumed the position of Financial Director PPL
Electric Utilities, where I was responsible for Business Planning and Services. In
September 2011, I assumed my current position of Controller.

Q. HAVE YOU PREVIOUSLY TESTIFIED AS A WITNESS IN
PROCEEDINGS BEFORE THE FEDERAL ENERGY REGULATORY
COMMISSION OR IN OTHER REGULATORY PROCEEDINGS?

A. Yes, I have testified before the Federal Energy Regulatory Commission (“FERC”
or “Commission”) in Docket No. EL12-20-000 and the Pennsylvania Public
Utility Commission (“PA PUC”) on behalf of PPL Electric in Docket No. R-
2010-2161694.
Q.  **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A.  The purpose of my testimony is to support PPL Electric’s request to recover a deferred income tax liability that currently is unfunded as a result of PPL Electric’s change in transmission ratemaking methodology for recovery of certain income taxes from flow-through to full normalization in accordance with Commission regulation. Specifically, my testimony describes how PPL Electric accounted for the deferred tax liability that resulted from PPL Electric’s compliance with the PA PUC’s requirement to flow through the tax reducing benefits of certain tax timing differences to ratepayers. My testimony and the supporting exhibits also demonstrate how PPL Electric calculated the amount of unfunded deferred tax liability that resulted from the switch from income tax flow-through to the Commission’s policy of full normalization in establishing public utility rates.

Q.  **PLEASE DESCRIBE THE DIFFERENCE BETWEEN THE FLOW-THROUGH METHOD AND NORMALIZATION.**

A.  Under the flow-through method, a regulated utility’s actual (current) taxes payable are used to establish its allowance for income taxes in cost-of-service ratemaking. Thus, in the case of accelerated depreciation, for example, the effect is to reduce a utility’s current cost-of-service and to lower utility rates. However, when the benefit of these timing differences reverses, the utility’s actual taxes payable are higher and these higher taxes are also flowed through to ratepayers resulting in higher utility rates.
In contrast, under normalization, the tax effects of the revenues and expenses are matched with the revenues and expenses themselves. Allowable taxes are based on the same plant amortization schedule as allowable capital charges such as return on equity and depreciation. Tax timing differences, such as accelerated depreciation, are reflected in a deferred tax reserve, which is treated as a cost-free component of capital to the extent that net timing differences provide tax reduction benefits. As the timing differences reverse and the benefits are exhausted, the utility draws down the deferred tax reserve. Thus, at any point in time, recorded deferred taxes should generally offset expected future tax liability in connection with the amortization of the remaining useful life of the utility’s plant.

Q. HOW HAS PPL ELECTRIC DETERMINED ITS RECOVERABLE INCOME TAXES IN ITS TRANSMISSION REVENUE REQUIREMENT?

Q. HOW DID PPL ELECTRIC RECORD ITS DEFERRED INCOME TAXES THAT RESULTED UNDER THE PA PUC FLOW-THROUGH ORDER?

A. From 1981 through 1992, PPL Electric recorded deferred income taxes in accordance with Accounting Principles Board Opinion No. 11 (“APB 11”), “Accounting for Income Taxes.” The deferred method used in APB 11 places an emphasis on the income statement and focuses on the matching of revenues and expenses for the years in which those expenses and revenues were realized. Following the deferred method’s and APB 11’s emphasis on matching revenues and expenses, from 1981 through 1992, PPL Electric did not record deferred income tax expense applicable to revenue items that received flow-through treatment in ratemaking. This practice continued until the issuance of the Financial Accounting Standard Board’s Statement of Accounting Standards No. 109 (“SFAS 109”).

Q. HOW DID PPL ELECTRIC’S ACCOUNTING FOR INCOME TAXES CHANGE AFTER SFAS 109 WAS ISSUED?

A. PPL Electric adopted SFAS 109 in January 1993. The adoption of SFAS 109 required a change from the deferred method to the asset and liability method of accounting for income taxes. Using the asset and liability method, deferred income tax assets and liabilities are recognized to reflect the tax consequences of temporary differences in the timing of recovery. To comply with SFAS 109, in January 1993, PPL Electric determined the tax benefits associated with production, distribution, and transmission assets that previously flowed through to customers and recorded an increase in its deferred tax liability in Accounts 190
and 283 to reflect that amount. SFAS 109 stated that regulated enterprises that meet the criteria for application of Statement of Accounting Standards No. 71 (“SFAS 71”), “Accounting for the Effects of Certain Types of Regulation,” are not exempt from the requirements of SFAS 109. SFAS 71 indicated that if, as a result of an action by a regulator, it is probable that the future increase or decrease in taxes payable will be recovered from or returned to customers through future rates, an asset or liability shall be recognized for that probable future revenue or reduction in future revenue and that asset or liability also shall be a temporary difference for which a deferred tax liability or asset shall be recognized. In accordance with SFAS 71, PPL Electric also recorded an asset of the same amount in Account 186 to recognize the probable recovery through the ratemaking process of the future increased taxes that PPL Electric expected to incur under the *PA PUC Flow-Through Order*. The actual journal entry recorded was as follows (in thousands):

<table>
<thead>
<tr>
<th>Account</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
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</thead>
<tbody>
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<td>186</td>
<td>Miscellaneous Deferred Debits</td>
<td>$1,076,101</td>
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<tr>
<td>190</td>
<td>Accumulated Deferred Income Taxes</td>
<td></td>
<td>$4,989</td>
</tr>
<tr>
<td>283</td>
<td>Accumulated Deferred Income Taxes – Other</td>
<td></td>
<td>$1,071,112</td>
</tr>
</tbody>
</table>

The above journal entry includes amounts applicable to production and distribution assets, as well as to transmission assets, as of January 1993.

In November 1993, to conform with the Commission’s issuance of *Order No. 552* and the creation of Account 182.3 in March 1993, PPL Electric moved the balance of regulatory assets in Account 186 to Account 182.3, Other Regulatory
Assets and applicable deferred income taxes from Account 283 to Account 282, Accumulated Deferred Income Taxes-Other Property. The balance of regulatory assets moved from Account 186 to Account 182.3 included the deferred tax liability that had accrued under the PA PUC Flow-Through Order. The actual journal entry which recorded that transfer was as follows (in thousands):

<table>
<thead>
<tr>
<th>Account</th>
<th>Description</th>
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<tbody>
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<td>182.3</td>
<td>Other Regulatory Assets</td>
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<tr>
<td>186</td>
<td>Miscellaneous Deferred Debits</td>
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</tbody>
</table>

Again, the above journal entries aggregate amounts applicable to production, distribution, and transmission assets as of November 1993. Once PPL Electric moved the balance of regulatory assets to Account 182.3, the annual changes in transmission-related deferred tax liability resulting from the PA PUC Flow-Through Order, plus a tax gross-up required to yield the total revenue that will be required when the timing differences reverse, were recorded in Account 182.3.

**Q. TO WHAT TAX TIMING DIFFERENCES DID THE PA PUC FLOW-THROUGH ORDER APPLY?**

**A.** Under the PA PUC Flow-Through Order, the tax and thus rate reducing benefits of the following items were flowed through to current ratepayers: (1) the state tax effect of timing differences related to book versus state tax method and life depreciation differences on all vintaged property; (2) the federal tax effect of the cumulative timing differences related to book versus federal tax method and life depreciation differences on vintaged property before the adoption of the
Accelerated Cost Recovery System ("ACRS")/Modified Accelerated Cost Recovery System ("MACRS"); (3) the federal and state tax effects of capitalizing overheads prior to the adoption of the Tax Reform Act of 1986; (4) the federal and state tax effects of capitalizing overheads subsequent to the adoption of the Tax Reform Act of 1986; and (5) the federal and state tax effects of timing differences related to the book versus tax treatment of cost of removal and salvage. As a result, higher future income tax allowances would have been necessary to recover PPL Electric’s tax expense in its transmission revenue requirement once benefits of the timing differences were exhausted. If PPL Electric had continued to determine its transmission revenue requirement in accordance with the PA PUC Flow-Through Order, its transmission revenue requirement would have increased to recover the actual taxes paid.

Q. HOW DID THE IMPLEMENTATION OF PPL ELECTRIC’S TRANSMISSION FORMULA RATE AFFECT THE ACCOUNTING OF PPL ELECTRIC’S DEFERRED TAX LIABILITY THAT ACCRUED UNDER THE PA PUC FLOW-THROUGH ORDER?

A. PPL Electric implemented its transmission formula rate for recovery of its transmission revenue requirement under the PJM Tariff on November 1, 2008. Under the formula rate, PPL Electric implemented full normalization to determine its allowable tax expense. However, PPL Electric did not initially make a corresponding change in its accounting to reflect this change. PPL Electric identified the mismatch between its accounting and ratemaking methodology in 2011 and made the necessary changes to correct it. At that time, PPL Electric
also determined that as a result of the conversion to full normalization from the flow-through method, it would not recover fully its deferred tax liability with respect to its transmission assets since its future rates under full normalization would not recover the higher actual taxes it will pay and which it would have recovered from ratepayers under the flow-through.

Q. WHAT STEPS DID PPL ELECTRIC TAKE TO CORRECT THE MISMATCH BETWEEN ITS ACCOUNTING AND RATEMAKING METHODOLOGY?

A. PPL Electric corrected the mismatch between its accounting and ratemaking methodology in 2011. PPL Electric also recorded the following to reflect amounts that should have been recorded as deferred income tax expense on its income statement after the implementation of the formula rate through December 2010 (in thousands):

<table>
<thead>
<tr>
<th>Account</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>410.1</td>
<td>Provision for Deferred Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>410.2</td>
<td>Provision for Deferred Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>411.1</td>
<td>Provision for Deferred Income</td>
<td></td>
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<tr>
<td>411.2</td>
<td>Provision for Deferred Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>182.3</td>
<td>Other Regulatory Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>182.3</td>
<td>Other Regulatory Assets</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Taxes, Utility Operating Income  $194,139
Taxes, Other Income and Deductions $13,047
Taxes – Credit, Utility Operating Income  $201,560
Taxes – Credit, Other Income and Deductions $5,387
Other Regulatory Assets  $239
The Debits/(Credits) in the above journal entry include amounts applicable to transmission-related assets and also aggregate the deferred income tax expenses applicable to 2008, 2009, and 2010. The deferred tax expenses applicable to the individual years were (in thousands) $165 (2008), $927 (2009), and $(853) (2010). PPL Electric also made comparable adjustments within Account 282 for the years in question to reflect the increase in transmission-related accumulated deferred income tax. The accounting described here will be reflected in PPL Electric’s 2011 FERC Form No. 1 to be filed in April 2012.

Q. HOW DID PPL ELECTRIC DETERMINE THE AMOUNT OF UNFUNDED TRANSMISSION TAX LIABILITY THAT RESULTED FROM THE SWITCH FROM FLOW-THROUGH TO FULL NORMALIZATION?

A. As I have explained, PPL Electric continuously recorded in Account 182.3 its deferred tax liability resulting from the PA PUC Flow-Through Order, plus a tax gross-up required to yield the total revenue that will be required when the timing differences reverse. However, that is not the only item that has been recorded in Account 182.3. The amount in Account 182.3 reported in FERC Form No. 1 also includes other regulatory assets that are associated with distribution, transmission, and general and intangible (“G&I”) plant and that are unrelated to the transmission-related deferred tax liability resulting from the PA PUC Flow-Through Order. Therefore, to determine the precise amount of unfunded transmission-related deferred tax liability recorded in Account 182.3 as of the time PPL Electric switched to full normalization upon the implementation of its
formula transmission rate on November 1, 2008, PPL Electric applied the *South Georgia* Method.

**Q. WHAT IS THE SOUTH GEORGIA METHOD?**

**A.** The *South Georgia* Method is a methodology that utilities have used after switching from flow-through to normalization to determine the appropriate “make-up” adjustment to ensure that the future reversal of timing differences that were created before the conversion to full normalization will not cause an under- or over-recovery of tax expenses. In general, the *South Georgia* Method calculates the appropriate “make-up” adjustment based on the difference between a utility’s total future deferred tax liability under normalization as of the date of conversion and the amount of deferred taxes previously recorded under flow-through. The result of the calculation is amortized over the remaining life of the relevant assets. In *Order No. 144*, in which the Commission adopted full normalization, it highlighted the *South Georgia* Method as a mechanism utilities may use to correct for future tax liabilities that are unfunded because of the switch from flow-through to normalization.

**Q. HOW WAS THE SOUTH GEORGIA METHOD USED TO CALCULATE PPL ELECTRIC’S UNFUNDED TRANSMISSION TAX LIABILITY THAT RESULTED FROM THE SWITCH FROM FLOW-THROUGH TO FULL NORMALIZATION?**

**A.** In Exhibit No. PPL-101 attached to my testimony, PPL Electric presents the *South Georgia* computation performed to calculate PPL Electric’s unfunded transmission-related tax liability that resulted from the switch from flow-through
to full normalization ("Transmission Regulatory Asset To Be Recovered"). In general, the South Georgia computation consists of the following three basic steps:

Step One: Determine the tax impact of the difference between the book and tax basis calculated using full normalization as of the date of conversion to the normalization under the formula rate ("Total Future Deferred Tax Liabilities");

Step Two: Determine the deferred taxes recorded in Accounts 190 and 282 under the PA PUC flow-through policies in place just prior to the conversion to full normalization under the formula rate ("Deferred Taxes Recorded Under Flow-Through"); and

Step Three: Subtract the Deferred Taxes Recorded Under Flow-Through from the Total Future Deferred Tax Liabilities to determine the deferred tax difference between normalization and flow-through and add a tax component to account for the fact that the additional revenue required to recover the additional tax expense will also be taxed as income ("Taxes Recoverable Through Future Rates").

Exhibit No. PPL-101 presents the three steps of the South Georgia computation for all of the functions of PPL Electric. Therefore, after the South Georgia computation in Exhibit No. PPL-101, the following two additional steps shown in Exhibit No. PPL-103 were performed to isolate the unfunded transmission-related deferred tax liability: (1) functionalize a portion of the G&I component of Taxes Recoverable Through Future Rates to transmission using a
wages and salary allocator and (2) combine the transmission component of Taxes Recoverable Through Future Rates and the functionalized portion of the G&I component of Taxes Recoverable Through Future Rates to determine the Transmission Regulatory Asset To Be Recovered.

Q. HOW DID YOU DETERMINE THE AMOUNTS TO BE ASSIGNED TO EACH OF PPL ELECTRIC’S SEPARATE FUNCTIONS IN EXHIBIT NO. PPL-101?

A. The total amounts in columns a and b are functionally assigned to transmission, G&I, and distribution. The functional assignment to transmission, G&I, and distribution is based on PPL Electric’s company records that are maintained pursuant to the Uniform System of Accounts and reported by PPL Electric’s tax depreciation and deferred tax software, PowerTax. PowerTax is a widely used and trusted tax software system that PPL Electric uses to compute, record, and track its tax treatment of its plant assets and related deferred taxes. A portion of the total amounts is also attributable to pending audit adjustments shown in columns i and j.

Q. WHAT AMOUNTS ARE INCLUDED IN THE AUDIT ADJUSTMENTS SHOWN IN COLUMNS I AND J OF EXHIBIT NO. PPL-101?

A. The audit adjustments include proposed adjustments to regulatory assets that have not yet been cash-settled with the Internal Revenue Service. These pending audit adjustments are calculated on an estimated basis and are not recorded in PowerTax or included in rate base until they are cash-settled. As shown on Line 21, the pending audit adjustments, once cash-settled and included in rate base,
would reduce the Taxes Recoverable Through Future Rates (Excluding Tax Gross-up) by $2,503,911. However, none of the $2.5 million is attributable to transmission, and the amount attributable to G&I (especially after it is functionalized to transmission) is negligible. Therefore, the pending audit adjustments, once cash-settled, will not materially affect the Transmission Regulatory Asset To Be Recovered.

Q. WHAT IS THE SOURCE OF THE BOOK AND TAX BASIS BALANCE AND RESERVE INPUTS THAT ARE USED IN STEP ONE OF THE SOUTH GEORGIA COMPUTATION IN EXHIBIT NO. PPL-101?

A. As I described above, the book basis balance and reserve amounts shown on Lines 4, 5, 11, and 12 of Exhibit No. PPL-101, as well as the tax basis balance and reserve amounts shown on Lines 1, 2, 8, and 9 were recorded pursuant to the Uniform System of Accounts and are the same amounts utilized by PPL Electric in its December 2008 calculation of its regulatory asset “Taxes Recoverable Through Future Rates” reported in PPL Electric’s 2008 FERC Form No. 1 at page 232, line 1, column f. Pursuant to PPL Electric’s standard accounting procedures, year-end deferred tax accruals that are reported in the FERC Form No. 1 are calculated based on ten months of actual data and two months of estimated data. By using the same data to calculate the Transmission Regulatory Asset To Be Recovered as was used to calculate deferred tax accruals in 2008 means that the Transmission Regulatory Asset To Be Recovered is consistent with the total deferred tax regulatory asset reported in Account 182.3 of the 2008 FERC Form No. 1. As such, Line 23 in column b of Exhibit No. PPL-101 is $257,210,500,
the same amount recorded in Account 182.3, “Taxes Recoverable Through Future Rates” and reported in PPL Electric’s 2008 FERC Form No. 1 at page 232, line 1, column f. For this reason, however, the book basis balance and reserve amounts used in the South Georgia computation shown in Exhibit No. PPL-101 do not match the plant book and reserve amounts reported in the 2008 FERC Form No. 1 since the latter are based on a full twelve months of actual data.

Q. WHY DID PPL ELECTRIC RELY ON DATA FROM 2008 IN ITS SOUTH GEORGIA COMPUTATION?

A. PPL Electric relied upon 2008 data in its South Georgia computation because PPL Electric’s formula rate was implemented in 2008. Also, as I explained before, PPL Electric’s accounting for timing differences continued to reflect flow-through treatment throughout 2008, even though PPL Electric’s conversion to full normalization ratemaking became effective on November 1, 2008. Thus, the data used to determine the inputs to the South Georgia computation I described above represent the book and tax basis differences utilized in PPL Electric’s December 2008 calculation of “Taxes Recoverable Through Future Rates” reported in PPL Electric’s 2008 FERC Form No. 1 at page 232, line 1, column f, which were applicable during the year of the implementation of PPL Electric’s formula rate and the conversion to full normalization. The use of the 2008 data is also consistent with the method used to allocate a portion of the G&I component of Taxes Recoverable Through Future Rates to transmission. As shown on Line 3 in Exhibit No. PPL-103, the wages and salaries allocator from the true-up of the formula rate to 2008 FERC Form No. 1 data that was posted as part of the 2009
formula rate annual update was used to allocate the appropriate amount of the
G&I component to transmission.

Q. WHAT DO THE COLUMNS IN EXHIBIT NO. PPL-101 REPRESENT?

A. Columns a and b represent the totals for each line across all of PPL Electric’s
functions. Columns c and d represent the amounts for each line that are
attributable to transmission plant. Columns e and f represent the amounts for each
line that are attributable to G&I plant. Columns g and h represent the amounts for each
line that are attributable to distribution. None of the distribution amounts are
included in the Transmission Regulatory Asset To Be Recovered. Columns i and
j represent the amounts for each line that are attributable to pending audit
adjustments, which I described above. Again, the pending audit adjustment
amounts are not material to the determination of the Transmission Regulatory
Asset To Be Recovered. Thus, only columns c through f contribute to the
calculation of the Transmission Regulatory Asset To Be Recovered.

Q. FOR STEP ONE, WHAT DOES EACH LINE IN EXHIBIT NO. PPL-101
REPRESENT?

A. Step One of the South Georgia computation is shown on Lines 1 through 18 of
Exhibit No. PPL-101. As I explained before, the book basis balance and reserve
amounts shown on Lines 4, 5, 11, and 12 of Exhibit No. PPL-101, as well as the
tax balance and reserve amounts shown on Lines 1, 2, 8, and 9, are as reported by
PowerTax. Lines 1 through 7 represent the calculation of the federal net book and
net tax basis difference, and Lines 8 through 14 represent the calculation of the
state net book and net tax basis difference. The federal net book and net tax basis
difference on Line 7 is then multiplied by the currently effective federal tax rate on Line 15 to determine Future Federal Tax Liability. Similarly, the state net book and net tax basis difference on Line 14 is multiplied by the currently effective state tax rate on Line 16 to determine Future State Tax Liability. The adjustment for the deductibility of state taxes from federal taxable income is represented by the Future Federal Benefit of State on Line 17. Currently effective tax rates were used to calculate future tax liability on Lines 15 through 17 because future rates are unknown at this time, and the currently effective tax rates are the only reasonable proxy.

The sum of Lines 15 through 17 is the Total Future Deferred Tax Liabilities in Line 18. As I explained above, this amount represents the tax impact of the difference between the book and tax basis calculated using full normalization as of the date of conversion to the normalization under the formula rate.

Q. FOR STEP TWO, PLEASE DESCRIBE WHAT EACH LINE IN EXHIBIT NO. PPL-101 REPRESENTS.

A. Step Two of the South Georgia computation that determines Deferred Taxes Recorded Under Flow-Through is represented by Line 19, Total Federal & State Deferred Taxes Recorded. As Exhibit No. PPL-101 indicates, the inputs to Deferred Taxes Recorded Under Flow-Through are from Account 190, Accumulated Deferred Income Taxes, and Account 282, Accumulated Deferred Income Taxes—Other Property. For transmission and G&I plant in particular, the Account 190 and 282 inputs to Line 19 are taken from Attachment 1 to PPL
Electric’s 2009 formula rate annual update of Attachment H-8G to the PJM Interconnection, L.L.C. Open Access Transmission Tariff. Except for projected capital additions going into service during the current year, PPL Electric’s formula rate is based fully on historical cost from the immediately preceding year. Thus, the 2009 Annual Update reflects final data from 2008. As shown in Exhibit No. PPL-102, the Deferred Taxes Recorded Under Flow-Through related to transmission consist of ACRS and MACRS less net basis adjustments and tax-related contributions in aid of construction (“CIAC”) recorded in Account 190. The Account 190 tax-related CIAC offsets the deferred taxes recorded on taxable CIAC at federal and state statutory income tax rates. Therefore, the amount of the regulatory asset for taxes recoverable that is related to CIAC is zero. The Deferred Taxes Recorded Under Flow-Through related to G&I also consist of ACRS and MACRS less net basis adjustments. The totals calculated on Line 4 of columns a and b on Exhibit No. PPL-102 are the same amounts used on Line 19 of Exhibit No. PPL-101 at columns d and f, respectively.

Q. **FOR STEP THREE, PLEASE DESCRIBE WHAT EACH LINE IN EXHIBIT NO. PPL-101 REPRESENTS.**

A. Step Three of the *South Georgia* computation is shown on Lines 20 through 23 of Exhibit No. PPL-101. Line 20 shows the difference between the Total Future Deferred Tax Liabilities calculated in Step One and the Deferred Taxes Recorded Under Flow-Through in Step Two. This difference represents the shortfall that
results from the conversion from flow-through to full normalization.\(^1\) To negate that shortfall, Line 21 reverses the sign of the amount in Line 20, yielding the Taxes Recoverable Through Future Rates (Excluding Tax Gross-up). Line 22 shows the Tax Gross-up amount that must be added because as the taxes are recovered in future rates, the amount recovered becomes taxable income. Currently effective tax rates were used to calculate the Tax Gross-up, rather than rates in effect when the unfunded tax liability was accumulated, because the additional taxable income that will be realized will be taxed at the rate in effect at the time. Even if PPL Electric had continued under the PA PUC’s requirements under the \(\textit{PA PUC Flow-Through Order}\), as the timing differences reversed, the amount recovered through rates would have been taxed at the rate in effect at that time. Because future rates are unknown at this time, the currently effective tax rates are the only reasonable proxy.

Line 23 represents the sum of Taxes Recoverable Through Future Rates including the Tax Gross-up and, thus, the Taxes Recoverable Through Future Rates that are recorded in Account 182.3. However, only the portion of the Total Taxes Recoverable Through Future Rates attributable to PPL Electric’s transmission-related function is relevant to the determination of the Transmission Regulatory Asset To Be Recovered.

\(^1\) Column j in Line 20 for pending audit adjustments is positive, but will not materially affect the Transmission Regulatory Asset To Be Recovered, for the reasons explained above.
Q. HOW DID YOU ISOLATE THE TRANSMISSION REGULATORY ASSET TO BE RECOVERED THAT IS PART OF TOTAL TAXES RECOVERABLE THROUGH FUTURE RATES?

A. As I explained above, by functionalizing transmission, G&I, and distribution based on amounts recorded pursuant to the Uniform System of Accounts and reported by PowerTax, the transmission component of Taxes Recoverable Through Future Rates and the G&I component of Taxes Recoverable Through Future Rates were separately identified. As shown on Line 23 of Exhibit No. PPL-101, the transmission and G&I component are $51,439,409 and $18,806,280, respectively. However, only a portion of G&I plant is attributable to PPL Electric’s transmission business that is subject to the Commission’s regulation. Therefore, a portion of the G&I component of Taxes Recoverable Through Future Rates was allocated to transmission using a wages and salary allocator. More specifically, in order to be consistent with the use of 2008 data throughout the South Georgia computation, the 10.0969% wages and salaries allocator from the true-up of the formula rate to 2008 FERC Form No. 1 data that was posted as part of the 2009 formula rate annual update was used to functionalize the appropriate amount of the G&I component to transmission. PPL Electric’s formula rate also used the wages and salaries allocator to allocate G&I plant to transmission. The allocated G&I component of Taxes Recoverable Through Future Rates is $1,898,851 and is shown on Line 4 Exhibit No. PPL-103.

Finally, the last step to determine the Transmission Regulatory Asset To Be Recovered involved merely adding the transmission component of Taxes
Recoverable Through Future Rates ($51,439,409 in Line 23, column d of Exhibit No. PPL-101 and Line 1 of Exhibit No. PPL-103) to the allocated G&I component of Taxes Recoverable Through Future Rates for a total of $53,338,260. This $53.3 million was recorded in Account 182.3 and represents the tax benefit flowed through to customers that would have been recovered through transmission rates in later years if PPL Electric continued to follow the PA PUC’s requirements under the **PA PUC Flow-Through Order**.

Q. **DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes, it does.
## A. Reconciliation of Federal Net Book/Net Tax

<table>
<thead>
<tr>
<th></th>
<th>12/31/2008</th>
<th>Transmission</th>
<th>General</th>
<th>Distribution</th>
<th>Audit Adjustments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Federal Tax Basis Balance</td>
<td>5,207,199,961</td>
<td>1,149,095,864</td>
<td>559,010,398</td>
<td>3,499,093,699</td>
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<tr>
<td>2</td>
<td>Less: Federal Tax Reserve</td>
<td>(3,427,579,819)</td>
<td>(642,078,531)</td>
<td>(316,527,552)</td>
<td>(2,489,517,969)</td>
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<tr>
<td>3</td>
<td>Net Federal Tax Basis Balance</td>
<td>1,779,620,142</td>
<td>507,017,333</td>
<td>242,482,846</td>
<td>1,009,575,730</td>
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<tr>
<td>4</td>
<td>Book Basis Balance</td>
<td>5,154,595,942</td>
<td>1,167,339,323</td>
<td>512,948,321</td>
<td>3,474,308,298</td>
</tr>
<tr>
<td>5</td>
<td>Less: Book Reserve</td>
<td>(2,024,048,652)</td>
<td>(474,879,808)</td>
<td>(148,744,273)</td>
<td>(1,380,501,430)</td>
</tr>
<tr>
<td>6</td>
<td>Net Book Basis Balance</td>
<td>3,130,547,290</td>
<td>692,459,515</td>
<td>364,204,048</td>
<td>2,093,806,868</td>
</tr>
</tbody>
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**Federal Net Book Basis Less Net Tax Basis:**

<table>
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<tr>
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<th>12/31/2008</th>
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<th>General</th>
<th>Distribution</th>
<th>Audit Adjustments</th>
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</thead>
<tbody>
<tr>
<td>7</td>
<td>(1,350,927,148)</td>
<td>(185,442,182)</td>
<td>(121,721,202)</td>
<td>(1,084,231,138)</td>
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## B. Reconciliation of State Net Book/Net Tax

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<tr>
<th></th>
<th>12/31/2008</th>
<th>Transmission</th>
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<th>Distribution</th>
<th>Audit Adjustments</th>
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<tbody>
<tr>
<td>8</td>
<td>State Tax Basis Balance</td>
<td>5,206,954,992</td>
<td>1,149,095,864</td>
<td>559,010,398</td>
<td>3,498,848,730</td>
</tr>
<tr>
<td>9</td>
<td>Less: State Tax Reserve</td>
<td>(3,303,192,335)</td>
<td>(622,200,560)</td>
<td>(315,392,549)</td>
<td>(2,386,143,459)</td>
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<tr>
<td>10</td>
<td>Net State Tax Basis Balance</td>
<td>1,903,762,657</td>
<td>526,895,304</td>
<td>243,617,849</td>
<td>1,122,705,271</td>
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<tr>
<td>11</td>
<td>Book Basis Balance</td>
<td>5,154,595,942</td>
<td>1,167,339,323</td>
<td>512,948,321</td>
<td>3,474,308,298</td>
</tr>
<tr>
<td>12</td>
<td>Less: Book Reserve</td>
<td>(2,024,048,652)</td>
<td>(474,879,808)</td>
<td>(148,744,273)</td>
<td>(1,380,501,430)</td>
</tr>
<tr>
<td>13</td>
<td>Net Book Basis Balance</td>
<td>3,130,547,290</td>
<td>692,459,515</td>
<td>364,204,048</td>
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**State Net Book Basis Less Net Tax Basis:**

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<tr>
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<th>Distribution</th>
<th>Audit Adjustments</th>
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<tr>
<td>14</td>
<td>(1,226,784,633)</td>
<td>(165,564,211)</td>
<td>(120,586,199)</td>
<td>(981,101,597)</td>
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## C. Reconciliation of Prior Excess & Prior Flow Through

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<tr>
<td>15</td>
<td>Future Federal Tax Liability @ 35%</td>
<td>(472,824,502)</td>
<td>(64,904,764)</td>
<td>(42,602,421)</td>
<td>(379,480,898)</td>
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<tr>
<td>16</td>
<td>Future State Tax Liability @ 9.99%</td>
<td>(122,555,785)</td>
<td>(16,539,865)</td>
<td>(12,046,561)</td>
<td>(98,012,050)</td>
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<tr>
<td>17</td>
<td>Future Federal Benefit of State @ 35%</td>
<td>42,894,525</td>
<td>5,788,953</td>
<td>4,216,296</td>
<td>34,304,217</td>
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<tr>
<td>18</td>
<td>Total Future Deferred Tax Liabilities</td>
<td>(552,485,762)</td>
<td>(75,655,676)</td>
<td>(50,432,685)</td>
<td>(443,188,731)</td>
</tr>
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**Total Federal & State Deferred Taxes Recorded (Accts 190,282):**

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<th></th>
<th>12/31/2008</th>
<th>Transmission</th>
<th>General</th>
<th>Distribution</th>
<th>Audit Adjustments</th>
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<tbody>
<tr>
<td>19</td>
<td>(402,000,901)</td>
<td>(45,560,278)</td>
<td>(39,429,789)</td>
<td>(331,298,253)</td>
<td>14,287,419</td>
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## Deferred Tax Difference between Normalization and Flow-Through

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<tr>
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<th>General</th>
<th>Distribution</th>
<th>Audit Adjustments</th>
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<tbody>
<tr>
<td>20</td>
<td>Deferred Tax Difference between Normalization and Flow-Through</td>
<td>(150,484,861)</td>
<td>(30,095,398)</td>
<td>(11,002,896)</td>
<td>(111,890,478)</td>
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**Taxes Recoverable Through Future Rates (Excluding Tax Gross-up):**

<table>
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<tr>
<th></th>
<th>12/31/2008</th>
<th>Transmission</th>
<th>General</th>
<th>Distribution</th>
<th>Audit Adjustments</th>
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</thead>
<tbody>
<tr>
<td>21</td>
<td>Taxes Recoverable Through Future Rates (Excluding Tax Gross-up)</td>
<td>150,484,861</td>
<td>30,095,398</td>
<td>11,002,896</td>
<td>111,890,478</td>
</tr>
<tr>
<td>22</td>
<td>Taxes Gross-up</td>
<td>106,725,639</td>
<td>21,344,011</td>
<td>7,803,384</td>
<td>79,354,047</td>
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<td>23</td>
<td>Taxes Recoverable Through Future Rates (Acct 182,3)</td>
<td>257,210,500</td>
<td>51,439,409</td>
<td>18,806,280</td>
<td>191,244,525</td>
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**Total (Exhibit PPL-102, Line 4):**

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<tr>
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<th>12/31/2008</th>
<th>Transmission</th>
<th>General</th>
<th>Distribution</th>
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<td>24</td>
<td>(150,484,861)</td>
<td>(30,095,398)</td>
<td>(11,002,896)</td>
<td>(111,890,478)</td>
<td>14,287,419</td>
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*All figures in columns c through h are based on ten months of actual data and two months of estimated data.
### PPL Electric Utilities Corporation
### Accumulated Deferred Taxes Recorded Under Flow-Through
### December 31, 2008

<table>
<thead>
<tr>
<th>Account</th>
<th>Description</th>
<th>a Source</th>
<th>b General and Intangible</th>
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<tbody>
<tr>
<td>Account 190</td>
<td>Contributions in aid of construction</td>
<td>PPL Electric 2009 Formula Rate Update, Attachment 1, P. 1 of 2.</td>
<td>$5,975,482</td>
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<tr>
<td>Account 282</td>
<td>ACRS/MACRS Plant</td>
<td>PPL Electric 2009 Formula Rate Update, Attachment 1, P. 2 of 2.</td>
<td>$ (54,509,528) $ (45,901,439)</td>
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<tr>
<td></td>
<td>Basis adjustments between book and tax plant</td>
<td></td>
<td>$ 2,973,768 $ 6,471,650</td>
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<tr>
<td>4 Total (Acct 190, 282)</td>
<td>Sum of Lines 1-3</td>
<td></td>
<td>$ (45,560,278) $ (39,429,789)</td>
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## PPL Electric Utilities Corporation
### Transmission Regulatory Asset To Be Recovered
#### December 31, 2008

<table>
<thead>
<tr>
<th>Source</th>
<th>Details</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Transmission Taxes Recoverable Through Future Rates (Acct 182.3)</td>
<td>Exh. PPL-101, Line 24, Col d</td>
</tr>
<tr>
<td>2</td>
<td>G&amp;I Taxes Recoverable Through Future Rates (Acct 182.3)</td>
<td>Exh. PPL-101, Line 24, Col f</td>
</tr>
<tr>
<td>3</td>
<td>Wages and Salaries Allocator</td>
<td>PPL 2009 Formula Rate Update, Line 5</td>
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<tr>
<td>4</td>
<td>Allocated G&amp;I Taxes Recoverable Through Future Rates</td>
<td>Line 3 x Line 2</td>
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<tr>
<td>5</td>
<td><strong>Transmission Regulatory Asset To Be Recovered</strong></td>
<td>Line 1 + Line 4</td>
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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PPL Electric Utilities Corporation

Docket No. ER12-___-000

Affidavit

I, the undersigned, being duly sworn, do depose and say, under penalty of perjury, that the Prepared Direct Testimony of Gary L. Banzhoff is the testimony of the undersigned, and that the exhibits sponsored by me to the best of my knowledge, information and belief, are true, correct, accurate and complete, and I hereby adopt said testimony as if given by me in formal hearing, under oath.

Gary L. Banzhoff

Subscribed and sworn before me this 27th day of March, 2012.

Notary Public

My Commission expires: 1-31-16
ATTACHMENT D
UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PPL Electric Utilities Corporation

) Docket No. ER12-___-000

PREPARED DIRECT TESTIMONY

OF

JOSEPH M. KLEHA
ON BEHALF OF PPL ELECTRIC UTILITIES CORPORATION
UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PPL Electric Utilities Corporation  )  Docket No. ER12-___-000

PREPARED DIRECT TESTIMONY
OF
JOSEPH M. KLEHA

1 Q. PLEASE STATE YOUR FULL NAME AND BUSINESS ADDRESS.
   A. My name is Joseph M. Kleha. My business address is Two North Ninth Street,
      Allentown, Pennsylvania 18101.

4 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?
   A. I am employed by PPL Electric Utilities Corporation ("PPL Electric"), a
      subsidiary of PPL Corporation, as its Manager – Regulatory Compliance and
      Rates. I assumed this position on January 12, 2009.

8 Q. WHAT ARE YOUR DUTIES AS MANAGER – REGULATORY
    COMPLIANCE AND RATES?
   A. I am responsible for PPL Electric’s compliance with the regulatory requirements
      of the Pennsylvania Public Utility Commission ("PA PUC"), the Federal Energy
      Regulatory Commission ("Commission" or "FERC") and other regulatory
      agencies, as necessary. As part of this function, I am responsible for the
      preparation and review, and technical oversight and guidance, of the
      development, content and structure of cost allocation and revenue requirement
      studies. In addition, I am responsible for all aspects of PPL Electric’s rates and
tariffs. I also prepare and present expert testimony regarding these and other cost-
of-service and ratemaking-related issues.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated from The Pennsylvania State University in 1974 with a Bachelor of
Science Degree in Accounting. Since that time, I have taken specialized courses
dealing with public utility accounting, depreciation and rate design. In addition, I
attended the National Association of Regulatory Utility Commissioners’
Regulatory Studies Program.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I was employed by the Pennsylvania Department of Public Welfare as Field
Auditor and Institutional Collections Officer from 1974 to 1977. In 1977, I joined
the technical staff of the PA PUC as a Utility Rate Analyst in its Bureau of Rates
and Research. In this position, my responsibilities included the review of
proposed retail electric rate filings and the preparation and presentation of
testimony in formal rate proceedings. This testimony primarily dealt with the
allowable levels and jurisdictional allocations of claimed operating revenues,
operating expenses and rate base. In 1981, I joined PPL Electric, formerly
Pennsylvania Power & Light Company, as a Senior Accountant with
responsibility for assembling financial data and preparing revenue requirement
studies to support its retail and wholesale rate filings. I was named Manager –
Regulatory Projects in PPL Electric’s Office of General Counsel in 1990. In
2000, as part of a corporate realignment, I became an employee of PPL Services
Corporation, along with the other employees in the Office of General Counsel. In 2009, I assumed my current position with PPL Electric.

Q. HAVE YOU PREVIOUSLY TESTIFIED AS A WITNESS IN PROCEEDINGS BEFORE THE COMMISSION OR IN OTHER REGULATORY PROCEEDINGS?

A. Yes, I have testified before the Commission, and the PA PUC, in numerous proceedings, including on behalf of PPL Electric in support of its transmission rate filing in FERC Docket No. ER97-4829-000 and of its current transmission formula rate that was approved by the Commission in Docket No. ER08-1457-000. In addition, I have testified regarding cost-of-service and ratemaking issues before the United States Tax Court at Docket No. 25393-07. See Appendix A for a listing of all the proceedings in which I have testified.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to support PPL Electric’s request to recover a deferred income tax liability that currently is unfunded as a result of a change in PPL Electric’s transmission ratemaking methodology regarding the recovery of certain income taxes from a flow-through method to a full normalization method, which is in accordance with Commission regulation. Specifically, my testimony describes how PPL Electric has recovered its transmission-related costs and expenses during different periods since 1981, when PPL Electric began to use the flow-through method to determine its recoverable income tax expenses for ratemaking purposes at the direction of the PA PUC. My testimony also will describe how PPL Electric has calculated its Monthly Deferred Tax Adjustment
Charge in Attachment H-8A of the PJM Interconnection, L.L.C. ("PJM") Open Access Transmission Tariff ("Tariff"), which it proposes to use to recover its unfunded deferred income tax liability. Finally, my testimony will explain why PPL Electric proposes to apply this Monthly Deferred Tax Adjustment Charge only to network service customers who serve PPL Electric retail electricity distribution customers and why PPL Electric does not propose to apply this charge to entities that historically were wholesale customers in PPL Electric’s transmission zone.

Q. WHY DID PPL ELECTRIC BEGIN TO USE THE FLOW-THROUGH METHOD TO DETERMINE ITS RECOVERABLE INCOME TAXES FOR RATEMAKING PURPOSES IN 1981?


we are guided by the Internal Revenue Code and the “actual taxes paid” doctrine as enunciated by the commonwealth court. Where the code is silent on the treatment to be afforded a particular matter, we perceive our duty to approximate the actual taxes to be paid by the utility, and pass that cost, and only that cost, on to ratepayers.

As a result of the PA PUC Flow-Through Order, PPL Electric’s regulatory income tax allowance was reduced to reflect the benefits of accelerated depreciation and other timing differences that were flowed through to its retail customers. Accordingly, PPL Electric’s PA PUC income tax allowance was
lower than it otherwise would have been under a full normalization ratemaking methodology. Consistent with the flow-through methodology, it was expected and understood that once the timing differences reversed, continued use of the flow-through method would result in a higher income tax expense that would be recovered from ratepayers as the benefits of the timing differences were exhausted.

Q. PLEASE DESCRIBE HOW PPL ELECTRIC RECOVERED ITS TRANSMISSION REVENUE REQUIREMENT FROM CUSTOMERS AT THIS TIME.

A. PPL Electric historically recovered almost its entire transmission revenue requirement through bundled retail rates that included the cost of transmission service regulated by the PA PUC. PPL Electric also served a few small wholesale customers located in what is now the PPL PJM Transmission Zone through Commission-jurisdictional bundled power sales contracts that included the cost of delivery. However, between 1981 and 1997, approximately 97% of PPL Electric’s transmission revenue requirement was recovered through bundled retail rates.

Q. HOW DID PPL ELECTRIC RECOVER ITS TRANSMISSION REVENUE REQUIREMENT FROM ITS WHOLESALE CUSTOMERS DURING THIS PERIOD?

A. In 1981, the Commission issued Order No. 144 adopting full tax normalization for treating the tax effects of certain timing differences in determining public utility rates under the Federal Power Act (“FPA”). Since that time, PPL Electric
complied with the Commission’s policy of full normalization in establishing its
allowance for income taxes under Commission-jurisdictional wholesale contracts.

Q. PLEASE DESCRIBE HOW PPL ELECTRIC RECOVERED ITS
TRANSMISSION REVENUE REQUIREMENT FROM CUSTOMERS
BEGINNING IN 1997.

A. Beginning in 1997, PPL Electric began to recover its transmission revenue
requirement through a stated transmission rate in the PJM Tariff. As a result of
the issuance of Order No. 888 and the requirement for transmission owners to
unbundle wholesale transmission from generation, on December 31, 1996, PPL
Electric, along with other transmission owners in PJM, submitted a series of
agreements to FERC to restructure PJM (“PJM Restructuring Proceeding”).
Contemporaneously, the Commonwealth of Pennsylvania was undertaking its
own restructuring effort to unbundle transmission and distribution delivery
charges from retail electricity sales pursuant to the Pennsylvania Electricity
Generation Customer Choice and Competition Act (“Competition Act”). Under
the Competition Act, PPL Electric maintained responsibility for retail electricity
distribution service, and either competitive retail suppliers (“Electric Generation
Suppliers”) or PPL Electric, as the default service provider, became responsible
for arranging the Network Integration Transmission Service under the PJM Tariff
used to serve PPL Electric’s retail distribution customers.

In order to harmonize the cost support and test period data used by PPL
Electric in the PJM Restructuring Proceeding before FERC and the retail
restructuring proceeding before the PA PUC, on September 30, 1997, PPL
Electric submitted a revised annual revenue requirement to FERC that relied upon the same cost-of-service unbundling analysis submitted to the PA PUC in Docket No. ER97-4829-000 (“Revenue Requirement Filing”). FERC accepted PPL Electric’s Revenue Requirement Filing, subject to refund, established hearing and settlement judge procedures, and consolidated the proceeding with the sub-docket created to address PPL Electric’s compliance filings in the PJM Restructuring Proceeding. FERC ultimately approved a “black box” settlement in that consolidated proceeding, which established a stated annual transmission service revenue requirement for PPL Electric and stated rate for transmission service in the PPL Zone.

Q. HOW WAS PPL ELECTRIC’S INCOME TAX ALLOWANCE DETERMINED IN ITS STATED ANNUAL TRANSMISSION SERVICE REVENUE REQUIREMENT THAT WAS ESTABLISHED IN THE SETTLEMENT?

A. As I explained previously, PPL Electric harmonized the cost support and test period data used in the PJM Restructuring Proceeding before FERC and the retail restructuring proceeding before the PA PUC using its cost-of-service unbundling analysis submitted to the PA PUC. Because this cost-of-service analysis had been submitted to the PA PUC, it was performed consistent with the *PA PUC Flow-Through Order* and relied upon the flow-through method for the treatment of tax savings resulting from tax timing differences. The settlement that established PPL Electric’s stated annual transmission service revenue requirement did not change how the tax benefits of accelerated depreciation or other timing
differences were treated. Thus, PPL Electric’s transmission ratemaking continued to be based upon the flow-through method of recovering tax expense until November 1, 2008, the effective date of PPL Electric’s cost-of-service transmission formula rate.

Q. **DID PPL ELECTRIC’S TRANSMISSION FORMULA RATE CHANGE HOW ITS INCOME TAXES FOR RATEMAKING PURPOSES WERE DETERMINED?**

A. Yes. In accordance with the Commission’s policies, PPL Electric’s transmission formula rate template, which it filed in Docket No. ER08-1457-000 on August 28, 2008, provides for the use of full normalization to determine the allowable income tax expense. Thus, when PPL Electric implemented its formula rate beginning on November 1, 2008, it changed its transmission ratemaking methodology for recovery of income taxes, including income tax savings that previously had been flowed through to ratepayers, to full normalization.

Q. **DID THE IMPLEMENTATION OF A TRANSMISSION FORMULA RATE AFFECT PPL ELECTRIC’S ABILITY TO RECOVER ITS DEFERRED INCOME TAX LIABILITY THAT ACCRUED UNDER THE FLOW-THROUGH METHOD?**

A. Yes. As I previously explained, under the flow-through method, PPL Electric’s allowable income tax expense was reduced to reflect the benefits of accelerated depreciation and other timing differences. As a result, PPL Electric’s allowable income tax expense was lower than it otherwise would have been under a full normalization ratemaking methodology. However, consistent with the flow-
through methodology, it was expected and understood that once the timing differences reversed PPL Electric would collect the resulting higher income tax expense from ratepayers as the benefits of the timing differences were exhausted. As a result of converting to full normalization, PPL Electric’s deferred tax liability that previously was accrued under the *PA PUC Flow-Through Order* will no longer be fully recovered, because the offsetting higher tax expenses that will occur in later periods will not be flowed through to its transmission customers under full normalization. Without an adjustment, the reversal of the timing differences will result in PPL Electric’s network service rates under-recovering its deferred income tax expense. PPL Electric’s transmission formula rate does not provide a mechanism to allow PPL Electric to make the necessary adjustment to address the shortfall in its revenue requirement resulting from the switch from flow-through treatment to full normalization that leaves its deferred tax liability unfunded. Accordingly, a separate charge to collect this revenue shortfall is necessary.

**Q. HOW DOES PPL ELECTRIC PROPOSE TO RECOVER ITS UNFUNDED DEFERRED TAX LIABILITY?**

**A.** PPL Electric proposes to recover its unfunded deferred tax liability through the Monthly Deferred Tax Adjustment Charge. The Monthly Deferred Tax Adjustment Charge will be a fixed monthly demand charge in Attachment H-8A of the PJM Tariff.
Q. WHICH CUSTOMERS WILL BE CHARGED THE MONTHLY DEFERRED TAX ADJUSTMENT CHARGE?

A. The Monthly Deferred Tax Adjustment Charge will apply only to network service customers serving retail electricity distribution customers of PPL Electric. More precisely, the terms of the revised Attachment H-8A limit the charge to network service customers that serve one or more customers taking retail electricity distribution service from PPL Electric under its PA PUC distribution tariff. As a result of Pennsylvania’s retail restructuring, the class of customers that are network service customers serving retail distribution customers includes Electric Generation Suppliers (“EGSs”) and PPL Electric, in its role as a default electric generation supplier to its distribution customers who are not taking generation supply service from EGSs. PPL Electric proposes to limit the Monthly Deferred Tax Adjustment Charge to these customers because they serve the retail customers who took service over PPL Electric’s transmission facilities at rates based on the flow-through method. These retail customers already received the benefits of the *PA PUC Flow-Through Order* and would have been responsible for the future higher income tax expense once the timing differences associated with those transmission facilities reversed and the benefits of the timing differences were exhausted.
Q. WILL PPL ELECTRIC’S FORMER WHOLESALE CUSTOMERS BE SUBJECT TO THE MONTHLY DEFERRED TAX ADJUSTMENT CHARGE?

A. No, they will not. Nor will the Monthly Deferred Tax Adjustment Charge apply to any wholesale transmission customer in the PPL Zone that does not serve any retail electricity distribution customer of PPL Electric. PPL Electric’s pre-Order No. 888 bundled wholesale customers were served under Commission jurisdictional agreements. Thus, PPL Electric’s income tax expense included in wholesale customers’ transmission rates would have been determined using full normalization in accordance with the Commission’s regulation and Order No. 144. As discussed below, this is the reason why PPL Electric is proposing to recover its unfunded tax liability resulting from the conversion to full normalization through a separate charge outside of PPL Electric’s formula rate, because the formula rate is applicable to all customers taking network transmission service in the PPL Zone.

Network transmission customers that were not serving PPL Electric’s retail distribution customers, but were taking network service from PJM over PPL Electric’s transmission facilities, received the benefit of the PA PUC’s flow-through policy between 1998 and 2008. However, PPL Electric did not record any regulatory asset for this future tax liability related to the PA PUC’s flow-through policies for these customers and, accordingly, is not seeking any recovery of its unfunded tax liability from such transmission customers.
Q. HOW WILL PPL ELECTRIC CALCULATE THE MONTHLY AMOUNT OF THE AMORTIZATION OF THE TRANSMISSION REGULATORY ASSET TO BE RECOVERED BY ATTACHMENT H-8A?

A. Consistent with the South Georgia method, PPL Electric proposes to recover the amount of the Transmission Regulatory Asset To Be Recovered, $53,338,260, calculated by Mr. Banzhoff, over a fixed period equivalent to the remaining useful life of the assets which generated the tax timing differences. Although the Transmission Regulatory Asset To Be Recovered was generated by tax timing differences for its transmission plant and general and intangible plant assets, PPL Electric proposes to use only the longer-lived transmission assets (which generated by far the largest portion of the transmission timing differences) to determine the amortization period. The amortization period was determined by dividing PPL Electric’s net transmission plant at the time its transmission formula rate was implemented in 2008 by PPL Electric’s 2008 transmission plant depreciation expense. Both figures were obtained from PPL Electric’s FERC Form No. 1. The transmission depreciation expense used to determine the amortization period is based on the 2008 depreciation study that had been submitted to and approved by the PA PUC in 2008. The same depreciation study was used to establish the final depreciation rates for the initial seven-month period of PPL Electric’s formula rate.

The result of the calculation described above is 33.9 years, which, as shown in Exhibit No. PPL-201, is rounded up to 34 years. Dividing the Transmission Regulatory Asset To Be Recovered by the 34-year amortization
period yields an annual recovery of $1,568,772 (“Annual Amortized Regulatory Asset To Be Recovered”) and a monthly recovery of $130,731 (“Monthly Amortized Regulatory Asset To Be Recovered”).

Q. **HOW WILL EACH CUSTOMER’S MONTHLY DEFERRED TAX ADJUSTMENT CHARGE BE DETERMINED?**

A. The Monthly Deferred Tax Adjustment Charge for each network service customer serving retail electricity distribution customers of PPL Electric will be determined by allocating the Monthly Amortized Regulatory Asset To Be Recovered among customers in the same manner as monthly network service charges are allocated, under Section 34.1 of the PJM Tariff, using the network service customer’s daily load coincident with the annual peak of the PPL Zone. However, as described above, the Monthly Deferred Tax Adjustment Charge will be allocated only among network service customers serving PPL Electric’s distribution customers, rather than all customers in the PPL Zone. As shown in the revised Attachment H-8A, the Monthly Deferred Tax Adjustment Charge will be determined by multiplying the Monthly Amortized Regulatory Asset To Be Recovered by the applicable individual network service customer’s annual peak load (net of behind the meter generation) divided by the coincident peak load of all network service customers serving PPL Electric’s distribution customers. Load growth or decline will not affect PPL Electric’s recovery, and it will recover only the stated Annual Amortized Regulatory Asset To Be Recovered each year because the shares and peak load are adjusted annually.
Q. **WHAT WILL THE RATE IMPACT OF THE MONTHLY DEFERRED TAX ADJUSTMENT CHARGE BE?**

A. The Monthly Deferred Tax Adjustment Charge is a measured and modest means of making PPL Electric whole for the income taxes that it will have to pay. Based upon PPL Electric’s 2011 coincident peak of 7,526.736 MW, the Monthly Amortized Regulatory Asset To Be Recovered will amount to a $17.37 per MW demand charge. Moreover, the Annual Amortized Regulatory Asset To Be Recovered represents less than one percent of PPL Electric’s 2011 Net Revenue Requirement of $176,519,180 calculated in its formula rate.

Q. **WHY HAS PPL ELECTRIC CHOSEN TO INCLUDE THE MONTHLY DEFERRED TAX ADJUSTMENT CHARGE IN ATTACHMENT H-8A TO THE PJM TARIFF?**

A. Attachment H-8A currently recovers the costs of serving certain municipal and cooperative customers within the PPL Zone at distribution level voltages. PPL Electric’s distribution plant includes facilities rated below 69 kV, and its transmission plant includes facilities rated at 69 kV and above. The distribution-level charges currently recovered through Attachment H-8A are not included in PPL Electric’s formula rate and, similarly, the Monthly Deferred Tax Adjustment Charge would recover costs not included in the formula rate.

Q. **ARE ANY CHANGES TO THE FORMULA RATE NECESSARY TO ENSURE PPL ELECTRIC RECOVERS ITS TAX EXPENSES?**

A. No. The formula rate correctly implements the Commission’s tax normalization policies.
Q. DID THE ACCOUNTING CHANGES NECESSARY TO CORRECT THE MISMATCH BETWEEN PPL ELECTRIC’S ACCOUNTING AND RATEMAKING METHODOLOGY, DESCRIBED IN MR. BANZHOFF’S TESTIMONY, AFFECT THE FORMULA RATE’S DETERMINATION OF TRANSMISSION RATES?

A. Yes. However, the effect on PPL Electric’s transmission rates is extremely small. The accounting changes affected Account 282, which is used to determine PPL Electric’s Accumulated Deferred Income Taxes (“ADIT”) in Attachment 1 to the formula rate. ADIT then is deducted from PPL Electric’s rate base at line 34 of Appendix A to the formula rate template. As Mr. Banzhoff explains, the correction of the accounting and ratemaking methodology mismatch results in an increase in Account 282 ADIT balances for 2008 and 2009, respectively, and a decrease in the Account 282 ADIT balance for 2010. If the correct amounts had been recorded in those years, the rates computed under the formula rate for the following years (i.e., the rates taking effect on June 1, 2009, 2010 and 2011) would have been affected because the formula rate template is populated with data from the previous year’s FERC Form No. 1.

The increases in Account 282 for 2008 and 2009 would have resulted in slightly lower rates in 2009 and 2010. If the correct amount had been recorded in 2010, the rate for 2011 would have been slightly higher. None of the changes would exceed 0.1%. As part of its 2012 formula rate update, PPL Electric will implement the changes to the data inputs from these years and refund any overcharges as appropriate. Any refunds will be implemented through PJM’s
billing process for the respective years. As noted by Mr. Banzhoff, PPL Electric corrected the mismatch between its accounting and ratemaking methodology in 2011, so future rates determined under its formula rate, including 2012 rates will properly reflect full normalization.

Q. WHEN IS PPL ELECTRIC PROPOSING THAT THE MONTHLY DEFERRED TAX ADJUSTMENT CHARGE TAKE EFFECT?

A. PPL Electric is proposing that the Monthly Deferred Tax Adjustment Charge become effective on June 1, 2012. This coincides with the effective date of the annual updates under its formula rate.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.
Proceedings in Which Mr. Kleha
Provided Expert Testimony

As an analyst in the Pennsylvania Public Utility Commission's ("PA PUC") former Bureau of Rates and Research, Mr. Kleha offered testimony in the following electric utility rate proceedings:

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<th>Docket No.</th>
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<tr>
<td>UGI Corp. - Luzerne Division</td>
<td>R-79050863</td>
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<td>Philadelphia Electric Company</td>
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<td>West Penn Power Company</td>
<td>R-80021082</td>
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<tr>
<td>Pennsylvania Power &amp; Light Co.</td>
<td>R-80031114</td>
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<td>Metropolitan Edison Company</td>
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As an employee of PPL Electric and PPL Services, Mr. Kleha has offered expert testimony in the following electric and gas utility proceedings before the PA PUC and the Federal Energy Regulatory Commission ("FERC").

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<th>FERC</th>
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* Includes Remand proceeding.
Appendix A
Page 2 of 2

PA PUC

Docket No. M-FACE0510
Docket No. M-FACE0511
Docket No. R-00061398
Docket No. P-00062227
Docket No. M-FACE0611
Docket No. M-FACE0612
Docket No. M-2008-2012856
Docket No. R-00061906
Docket No. R-2008-2013780
Docket No. R-00072155
Docket No. A-2008-2034047 etc.
Docket No. P-2008-2060309
Docket No. A-2008-2022941
Docket No. M-2008-2078645
Docket No. M-2008-2078647
Docket No. M-2008-2078709
Docket No. M-2008-2078713
Docket No. A-2009-2082652
Docket No. M-2009-2093216
Docket No. M-2009-2123945
Docket No. P-2009-2129502
Docket No. R-2009-2122718
Docket No. M-2009-2145186
Docket No. M-2009-2145189
Docket No. M-2009-2145838
Docket No. M-2009-2145273
Docket No. R-2010-2161694*
Docket Nos. C-2010-2160921/
   C-2010-2164071
Docket No. M-2010-2213701
Docket No. M-2010-2213731
Docket No. M-2010-2213754
Docket No. M-2010-2208246
Docket No. M-2011-2239839
Docket No. M-2011-2240268
Docket No. M-2011-2240269
Docket No. M-2011-2240273
Docket Nos. C-2011-2245906/M-
   2011-2243137
Docket No. P-2011-2256365
Docket No. M-2011-2258256
Docket No. R-2011-2264771
Docket No. M-2011-2276341

FERC

* Includes Remand proceeding.
## PPL Electric Utilities Corporation
### Computation of the Monthly Deferred Tax Adjustment Charge

<table>
<thead>
<tr>
<th>Source</th>
<th>Description</th>
<th>Value</th>
<th>Source Line/Line Reference</th>
<th>Notes</th>
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<tr>
<td>1</td>
<td>Transmission Plant in Service as of December 31, 2008</td>
<td>$1,150,044,754</td>
<td>2008 Form No. 1, p. 207, line 58g</td>
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<td>2</td>
<td>Transmission Accumulated Depreciation</td>
<td>(479,905,629)</td>
<td>2008 Form No. 1, p. 219, line 25c</td>
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<td>Transmission Net Plant in Service as of December 31, 2008</td>
<td>$670,139,125</td>
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<td>2008 Transmission Depreciation Expense</td>
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<td>2008 Form No. 1, p. 336, line 7f</td>
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<td>5</td>
<td>Average Remaining Useful Life in Years</td>
<td>34</td>
<td>Line 3/Line 4</td>
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<td>6</td>
<td>Transmission Regulatory Asset To Be Recovered</td>
<td>$53,338,260</td>
<td>Exhibit PPL-103, line 5</td>
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<td>7</td>
<td>Annual Amortized Regulatory Asset To Be Recovered</td>
<td>$1,568,772</td>
<td>Line 6/Line 5</td>
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<td>8</td>
<td>Monthly Amortized Regulatory Asset To Be Recovered</td>
<td>$130,731</td>
<td>Line 7/12</td>
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</tbody>
</table>
UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

) )
PPL Electric Utilities Corporation ) Docket No. ER12-___-000
) )

Affidavit

I, the undersigned, being duly sworn, do depose and say, under penalty of perjury, that the Prepared Direct Testimony of Joseph M. Kleha is the testimony of the undersigned, and that the exhibits sponsored by me to the best of my knowledge, information and belief, are true, correct, accurate and complete, and I hereby adopt said testimony as if given by me in formal hearing, under oath.

[Signature]
Joseph M. Kleha

Subscribed and sworn before me this
30th day of March, 2012.

[Signature]
Notary Public

COMMONWEALTH OF PENNSYLVANIA

My Commission expires: July 16, 2012