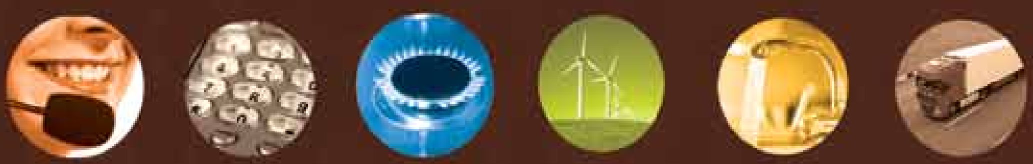
2008-09

PENNSYLVANIA PUBLIC UTILITY COMMISSION
ANNUAL REPORT



The Pennsylvania Public Utility Commission balances the needs of consumers and utilities to ensure safe and reliable utility service at reasonable rates; protect the public interest; educate consumers to make independent and informed utility choices; further economic development; and foster new technologies and competitive markets in an environmentally sound manner.

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James H. Cawley
Chairman


Tyrone J. Christy
Vice Chairman


Kim Pizzingrilli
Commissioner


Wayne E. Gardner
Commissioner


Robert F. Powelson
Commissioner

The Honorable Edward G. Rendell
Governor of Pennsylvania

The Honorable Joseph Scarnati
Lieutenant Governor of Pennsylvania

Members of the General Assembly

It is our pleasure to submit the 2008-09 Annual Report for the Pennsylvania Public Utility Commission outlining the accomplishments and challenges that come with our responsibility to foster a competitive marketplace for utilities while maintaining our traditional regulatory duties. The PUC has transformed from being regulators of the past to being regulators, market monitors, protectors, advocates, educators, and promoters of new technology.

The end of the decade-long transition period for electric restructuring draws near. We continue to work with the administration and legislature to mitigate the impact of the anticipated increases through such measures as: energy efficiency and conservation; demand side response; default service supply procurement; rate mitigation programs; updated low-income programs; removal of barriers to retail choice; and consumer education.

Act 129 of 2008, with its accelerated implementation timeline, has significantly increased the PUC's responsibilities and workload. We have met or exceeded all of the implementation goals set forth in the legislation. We shall continue to work diligently to ensure the timely implementation of the remaining elements of the plan while monitoring compliance with the law.

As part of our ongoing efforts to work with consumers to create an understanding of the energy environment in Pennsylvania and to empower them to take responsibility for their energy usage, the Commission reached out to consumers through the "Prepare Now" campaign and actively participated in the Governor's "Turn Down. Seal Off. Save Up" program. We participated in outreach activities across the state in an effort to help consumers better manage their energy usage and become more energy efficient.

The Commission also initiated an action plan with measures designed to increase competition in Pennsylvania's retail natural gas services market. The action plan will be implemented in two phases, will be completed within two years, and will be subject to five-year milestone reviews to evaluate progress.

The work to overhaul the PUC's existing case management system moved forward substantially this fiscal year. Our Information Management Access Project – InfoMAP – significantly improved our electronic workflow capability and provided more efficient access to Commission information by consumers, utilities and practitioners and implemented electronic filing and other e-commerce initiatives.

In Fiscal Year 2008-09, we continued to refine the application of three comprehensive laws that made sweeping changes to the way energy and water utilities terminate customers; the way electric utilities and their consumers embrace the use of alternative energy sources for generations; and the way telephone companies are regulated and deploy high-speed Internet services across Pennsylvania.

Also, the federal government -- the Federal Energy Regulatory Commission and the Federal Communications Commission -- is playing an increasingly important role in the delivery of energy and telephone service in Pennsylvania. We have, therefore, increased our monitoring and pariticipation in these arenas.

In the water industry, the Commission increased its efforts to assist water utilities in tracking levels of unaccounted-for water. Through the water audit pilot program, water utilities are now provided with an effective, standardized structure to help them quantify loss volumes and assign cost impacts to the losses, which will further infrastructure reliability, help to preserve water resources, limit water leakage, and enhance customer service.

In Fiscal Year 2008-09, the Commission continued with its monitoring of the state's aggressive broadband deployment initiatives as required by Act 183 of 2004, which requires that every Pennsylvanian have access to broadband services, even in the more rural areas.

In the transportation industry, the Commission continued with its public outreach efforts by speaking to groups about paratransit services across the state while enhancing oversight of the motorcoach industry. The Commission focused on rail safety efforts across the Commonwealth, including safety inspections and investigations of railroad facilities, equipment and records.

We continue with our mission to balance the needs of consumers and utilities to ensure safe and reliable utility service at reasonable rates; protect the public interest; educate consumers to make independent and informed utility choices; further economic development; and foster new technologies and competitive markets in an environmentally sound manner. We stand ready to face the challenges in the coming year.

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INTRODUCTION

Utility service is a critical element to the health and safety of Pennsylvania's residential and business customers. The Pennsylvania Public Utility Commission (PUC) ensures that electric, natural gas, water and telecommunications services are available upon request at a reasonable rate and provided safely with a reliable level of service. Similarly, customers using taxis, moving trucks or motor coaches expect fair rates and adequate service. The Commission also works to promote the safety of public highway-railroad crossings and compliance with railroad regulations.

With the restructuring of Pennsylvania's electric, natural gas and telecommunications industries, the Commission's role also is to oversee that transition and to educate customers so they may make informed utility choices.

Under the law, utilities are entitled to the opportunity to earn fair rates of return. The PUC recognizes that it is in the long-term public interest to permit a strong financial climate for investment in public utilities. By allowing a fair return to investors, companies can attract capital to provide and improve services for all customers.

Organization

The Commission is comprised of five full-time members nominated by the Governor for staggered five-year terms. The nominations must be approved by a majority of the state Senate. The Commissioners set policy on matters affecting utility base rates and services, as well as on personnel, budget, fiscal and administrative matters. Commissioners take official action on cases during regularly scheduled public meetings.

The Commission has its headquarters in Harrisburg with regional offices in Altoona, Philadelphia, Pittsburgh and Scranton. In Fiscal Year 2008-09, the Commission continued to strive to create a more open and user-friendly PUC. Information about the PUC, including copies of documents filed with and produced by the Commission, audio of certain Commission proceedings, forms, applications and summaries of public meetings, is available at www.puc.state.pa.us.

The PUC oversees nearly 8,600 entities furnishing the following in-state services: electricity; natural gas; telephone; water and wastewater collection and disposal; steam heat; transportation of passengers and property by motor coach, truck and taxicab; pipeline transmission of natural gas; and public highway-railroad crossings. Municipal utility service

is exempt from PUC regulation, with the exception of services furnished beyond a municipality's corporate boundaries. Rural electric cooperatives, school buses, bottled water, heating oil, cable television, Internet service providers and wireless telecommunications services also are exempt from PUC regulations.

The Commission is funded by assessments of the regulated public utilities. The PUC may assess utilities up to three-tenths of 1 percent of gross intrastate revenue to cover the cost of regulation. Assessments are paid into the state Treasury's General Fund for use solely by the Commission.

The Public Utility Commission was created by the Pennsylvania Legislative Act of March 31, 1937, which abolished the Public Service Commission.

Broad Powers

The PUC exercises broad powers in meeting its regulatory obligations. In today's rapidly changing business environment, utilities must consider all of their options. Utility mergers, rate change requests, acquisitions and affiliated interest agreements continue to be filed before the Commission at a steady pace. With limited exceptions, utilities are required to obtain Commission approval for these transactions, as well as to operate, extend or abandon service. The PUC's responsibility is to ensure these actions are in the public interest.

The PUC also works diligently to ensure an effective transition to competitive markets in the electric, natural gas and telecommunications industries. The move toward competitive electricity markets through the passage of the Electricity Generation Customer Choice and Competition Act was based primarily on the legislative finding that "competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."

Although the natural gas and electric supply markets are subject to competition, customers still receive transmission and distribution service from their local utilities. The local utilities also continue to maintain the electric lines or natural gas pipelines to ensure that safe, reliable utility service is delivered to customers.

The state is nearing the end of the transition period for the restructuring of electric utilities. As part of an overall strategy for preparing consumers for increases in electricity supply costs, the Commission has established regulations and policy statements that set the rules for default service for electric generation. The PUC has engaged consumer advocates and industry experts in efforts to mitigate any increases in future electric generation prices. The PUC has been working to educate consumers; develop strategies to remove barriers for suppliers providing competitive electric service; approve phase-in or pre-payment plans and direct all utilities to file such programs if electric rates increase by more than 25 percent; update low-income programs that provide customer assistance; and implement default service pricing that reflects the least cost to consumers over the long term. We also are continuing to implement reasonable, cost-effective programs that consumers and companies can implement to conserve energy or use it more efficiently.

Over and above regulating rates for motor carriers that transport property, passengers and household goods, the PUC is responsible for enforcing rail and motor carrier safety laws. Motor vehicle and railroad facility and track inspections are important components of the PUC's safety program. The PUC also resolves complaints about unsafe conditions at rail crossings and enforces common carrier compliance with safety and insurance requirements.

If customers have complaints about a utility, they may seek help by calling a toll-free number and speaking with the PUC's Bureau of Consumer Services. Trained customer service representatives help to resolve billing and quality of service issues, establish payment plans or restore service. The toll-free number is 1-800-692-7380.

Rates

In order to provide economical and efficient service to Pennsylvania communities, the state grants electric distribution, natural gas distribution, steam heat, local telecommunications, water and wastewater companies the right to provide their service within a specified geographic area. History shows and economics dictate that the construction of energy and water distribution facilities by multiple utilities in the same location would be extremely costly and disruptive to communities. The utility is then regulated by the PUC to assure just and reasonable rates for safe and adequate service.

Competition is permitted in the supply of electricity and natural gas. Charges for the supply of electricity and natural gas by licensed competitors are not regulated and are based on market prices. The PUC exercises no jurisdiction over those market prices. Many electric utilities are operating under negotiated generation rate caps for supply services. The prices for the delivery through the distribution system of electric and natural gas continue to be regulated by the PUC.

Competition also is permitted for telephone service. Most incumbent local telephone companies operate under a price stability formula that limits their ability to seek rate and revenue increases based on the rate of inflation and other factors. The rates for competitive local exchange carriers that are competing against the incumbent local telephone companies also require PUC approval. Legislation passed in 2004 categorized interexchange carrier services, such as long-distance toll, as competitive and subject to permissive tariffs. The long-distance company has the option of maintaining a tariff on file with the Commission or operating without a tariff subject to state contract law.

Filing for a Fixed Utility Rate Increase

When a regulated utility, other than telecommunications providers, seeks a distribution rate increase, it must file a request with the PUC that shows the proposed new rates and effective date, and must prove that the increase is needed. The utility also must notify customers at least 60 days in advance of the filing of the proposed effective date. The notice must include the amount of the proposed rate increase, the proposed effective date and how much more the ratepayer can expect to pay.

A handful of incumbent local exchange carriers have simplified ratemaking plans, similar to the regulatory regimes described above. However, a general rate increase for telecommunications utilities follows a different path due to the more advanced state of competition. Major rate revisions for incumbent local exchange carriers under price cap regulation are subject to a rate ceiling for residential dial tone, an inflation formula, and company-specific criteria and filing deadlines ranging from a 30-day Commission review period to a 90-day Commission review period. Competitive local exchange carriers, long-distance toll providers, and competitive access providers may file rate revisions under either a one-day or a 30-day notice period, depending on the type of filing.

How Are Rates Set?

The standard ratemaking process ensures the lowest reasonable rate for consumers while maintaining the financial stability of utilities. Under the law, the utility has the opportunity for recovery of its reasonably incurred expenses and a fair return on its investment. The PUC evaluates each utility's request for a rate increase based on those criteria.

How Long Does It Take?

By operation of law, the rate request for electric, natural gas, steam heat, water or wastewater companies is suspended for up to seven months if the PUC does not act before the proposed effective date. The PUC uses that time to investigate and determine what if any portion of the requested increase is justified. During the investigation, hearings are held before an Administrative Law Judge (ALJ), at which the evidence in support of the rate increase is examined and expert witnesses testify. In addition, consumers are offered an opportunity to voice their opinions and give testimony. Briefs may be submitted by the formal parties. A recommendation to the PUC is made by the ALJ. Finally, the matter is brought before the Commissioners for a vote and final decision. Including the 60-day notice period, the rate increase process takes about nine months.

Hearings and Recommendations

When the PUC investigates a rate increase, it is assigned to an ALJ, who is an attorney with experience in administrative law. The ALJ presides at formal hearings, which are open to the public and conducted like a formal court proceeding.

At the formal hearing, the company, the PUC's Office of Trial Staff (OTS) and other parties such as the state's Office of Consumer Advocate and the state's Office of Small Business Advocate present evidence and their witnesses are subject to cross-examination. OTS reviews the company's records and requests, and presents its view regarding what is in the public interest.

Individual ratepayers may become formal parties by filing a formal complaint. Ratepayers may speak for themselves, or an attorney may represent individual ratepayers or groups of ratepayers. Consumers also can have their say informally by writing or calling the PUC or by testifying at a public input hearing, that may be conducted by the ALJ in the utility's service territory. By providing testimony, consumers place their views in the official file on the case. Consumer testimony becomes part of the record on which the PUC will base its decision.

After weighing the evidence and hearing the arguments, the ALJ writes a recommended decision addressing each issue in the case within the limits set by law. The recommended decision may approve, disapprove or modify the original request. Parties may file exceptions to the judge's decision. Subsequently, reply exceptions may be filed. Sometimes, rate cases are resolved after all of the parties reach a settlement on the issues. The entire matter is then sent to the Commissioners for a vote at a public meeting.

Final Order

The Commissioners make the final decision, authorizing rates that: (1) permit revenues that allow the company to meet its reasonable expenses, pay interest on its debt and provide a fair return to stockholders so it will continue to attract investment; and (2) assign the proper rate for residential, commercial and industrial customers that attempts to reflect the cost of service. The Order has the weight of law unless the PUC changes it in response to a petition for reconsideration, or it is successfully challenged in court.

Ratepayer Role

By law, ratepayers must pay for the service they use, which includes a share of the reasonable cost of utility company expenses such as operating and maintenance expenses, administrative expenses, depreciation, and taxes. While the ratemaking process is complex, consumers have the right to be informed about the process, receive an explanation of their utility bills, have their complaints addressed in a prompt and fair manner, and receive continuous utility service if payment responsibilities are met.

Consumers have a right to participate in the ratemaking process and can do so by filing an informal complaint, which can include attending and/or testifying at a public input hearing. They also can file a formal complaint or complete an objection and comment form for rate cases. Forms and additional information about filing a complaint are available at www.puc.state.pa.us.

Multi-Utility Issues

InfoMAP

An enhanced website search engine and an improved case management system have shaped a PUC that is more accessible than ever. The leading factor in this is the implementation of a new case and document management system – InfoMAP (Information Management and Access Project). The legislature provided funding for the replacement of our computer system that dated from the late 1970s. InfoMAP automates workflows, reduces reliance on paper copies and improves public access to PUC information.

InfoMAP overhauled the PUC's case management system, improving the Commission's docketing, tracking and sharing of information. It also provides a single entry point to submit and access information, initiate transactions and conduct business, thereby permitting electronic filings and giving the public electronic access to information filed with and produced by the PUC. InfoMAP went live in January 2008, and immediately the paper flurry within the Commission was significantly reduced.

Since the implementation of InfoMAP, access by external users to information maintained by the PUC has improved significantly, with most filings being eFiled or scanned and published to the website. This means interested parties can view filings made with the PUC online instead of coming to PUC offices to review paper files.

eFiling

On Feb. 17, 2009, the PUC began allowing all users including consumers, utilities and practitioners to begin eFiling. The widespread availability of eFiling was the latest step in creating a more open and transparent PUC.

After a successful pilot program, the PUC was able to utilize customer feedback to create a system

that was customer friendly and ready for use. The PUC's eFiling pilot program began on Dec. 8, 2008, with about 20 participants.

A link to the eFiling system is available from the PUC website at www.puc.state.pa.us. The website includes instructions on how to set up an account, access the users' guide and preview the system.

eFiling also allows users to pay PUC filing fees via the website using a credit card. Only "qualified documents," designated by the Commission, are eligible for eFiling. Qualified documents include:

- Applications;
- Formal complaints;
- Comments;
- Exceptions;
- Reply exceptions;
- Petitions;
- Protests;
- Rate filings;
- Security certificates; and
- Supporting documents such as briefs, reply briefs and motions.

Public Utility Confidential Security Information Disclosure Act

On May 2, 2008, the PUC entered an order approving the final rulemaking for the Public Utility Confidential Security Information Disclosure (CSI) Act, or Act 156, which is designed to safeguard confidential security information of all public utilities. The final regulations were subsequently approved by the Independent Regulatory Review Commission on July 10, 2008, and became effective on Aug. 23, 2008, when they were published in the *Pennsylvania Bulletin*.

The rulemaking implemented a comprehensive set of regulations that apply to all public utilities in the Commonwealth relating to the filing requirements and challenge procedures outlined in the CSI Act. The CSI Act, which was signed into law on Nov. 29, 2006, directs each state agency to promulgate these regulations to ensure the safeguarding of confidential information that may compromise security against sabotage or criminal or terrorist acts.

The regulations require the utility to label each page of the record containing confidential security information with the words "Confidential Security Information" and to file the affected pages in a separate envelope.

The Commission also adopted a series of internal procedures for Commission employees to follow that address how confidential security information supplied by utilities is to be handled when filed with the Commission. The PUC's Secretary's Bureau files these documents in a secure, locked cabinet or file area, with access limited to authorized Commission employees who have received training and who have properly executed an access agreement.

Confidential security information includes vulnerability assessments, emergency response plans, maps of drinking water supplies, and security plans.

Annual Assessment Report Review

The Commission conducted a review of selected fixed utility and motor carrier Annual Assessment Reports. The Annual Assessment Report requires public utilities to submit operating revenues, including "total gross operating revenues," and "gross intrastate revenues" utilized to determine each public utility's appropriate annual assessment.

Fixed Utilities

Twenty-one fixed utilities' Annual Assessment Reports representing operating revenue activities for 2008 have been reviewed. Of the 21 fixed utilities' reports reviewed, six had no discrepancies. Two filed an amended assessment report after finding that the reported intrastate revenue was incorrect, and the remaining 13 reconciled their reports as requested with minor discrepancies.

Staff intends to improve the filing instructions for the assessment report and rework the annual report line item presentation for intrastate revenues to provide for ease in future reconciliations and reviews.

Motor Carrier Utilities

Since the review of assessable revenues within this industry includes verification of "excludable" revenues, an on-site visit is necessary. The Bureau of Audits has visited four of the six motor carriers selected for revenue review. The Bureau is in the process of finalizing its report for each of these companies and will conduct the remaining two site visits prior to year-end 2009.

The process employed while reviewing these assessment reports focused on revenues of motor carrier companies, which includes tracing gross intrastate revenue to the general ledger, examination of general ledger accounts to determine the validity and accuracy of amounts claimed as exempt from assessable revenue and the review of customer contracts. The Commission will determine what, if any, subsequent steps may be required to move toward consistency in claimed exemptions within each segment of the motor carrier industry.

Funding Level Status of Utility Pension Plans

On March 5, 2009, the Commission issued six directives to larger jurisdictional utilities that are subject to ongoing management audits to provide data regarding the status of their defined pension plans. Each of the 19 larger utilities submitted timely answers to the directives summarized.

The Commission is reviewing the relevant sections of the Pension Protection Act of 2006 (PPA) as well as the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) regarding funding requirements. The PPA enacted new minimum funding standards, which were later modified by WRERA.

It is common for pension funds to be heavily invested in marketable securities such as stocks, bonds and mutual funds. The steep decline in the value of these liquid assets during 2008 and to some extent in 2009 had an impact upon the actuarial value of pension funds. This loss in asset value drove eight of the 19 companies' plans below the 80 percent benchmark funding requirement imposed by the Employee Retirement Income Security Act of 1974 (ERISA). The PPA provides that the funding shortfall may be made up over the next seven years.

Each of our responding utilities has stated that every effort will be made to comply with the PPA and WRERA requirements. These efforts include cash payments into the pension funds, realignment of investments within the funds and the close monitoring of the effectiveness of the funds' managers. Pursuant to the March 5, 2009 directives, the Commission will be tracking the funding practices of these utilities over the next three years by reviewing their annual pension plan valuation reports.

Homeland Security & Emergency Preparedness

When it comes to emergency preparedness and security, the Commission has a direct support relationship with the Pennsylvania Emergency Management Agency (PEMA) and other Commonwealth agencies and commissions.

During emergencies, a Commission team mobilizes at the Pennsylvania State Emergency Operations Center (SEOC) in Harrisburg. The PUC Emergency Management Response Team (ERT) under the direction of the Emergency Preparedness Coordinator provides assistance to utilities responding during an emergency, and coordinates with other state agencies to ensure that all available resources are being used. Its primary goal is to quickly and effectively meet the needs of those responding to an emergency. The team also makes sure a clear line of communication is available from the utilities to the PUC, PEMA, the Governor and his staff, as well as other Commonwealth agencies and commissions.

The Commission also has liaisons from its bureaus of Fixed Utility Services, and Transportation and Safety who act as round-the-clock contacts for PEMA for utility-related emergencies on an ongoing basis. The PUC also has a seat on the Commonwealth Emergency Management Council.

The ERT responded to mobilizations at the SEOC in December 2008 due to significant snow, sleet and freezing rain, and in October 2008 due to an early and large snowfall in the Northwest and Northeast. In addition, throughout the stormy winter and summer months, the Emergency Preparedness Coordinator participates in conference calls and emergency meetings with PEMA, the National Weather Service, and other Commonwealth agencies and commissions to discuss the preparedness of the utilities and the ERT for the potential effects of an anticipated storm.

The Commission also works with the utility industry, state agencies and other stakeholders through several task forces and working groups, including the Drought Task Force, Pennsylvania One Call, Commercial Vehicle Safety Alliance, Federal Railroad Administration, Pennsylvania Water/Wastewater Agency Response Network (PAWARN), 9-1-1 Task Force and several National Association of Regulatory Utility Commissioners (NARUC) committees. The Commission has developed relationships with the nine regional counter-terrorism task forces, and acts as a liaison among the utilities and county emergency management agencies when necessary.

The Commission ERT has undergone Homeland Security sponsored training and is certified in the National Incident Management System (NIMS) and the National Response Framework. Throughout the year, the ERT participates with PEMA on developing and executing several training exercises, including winter weather drills and nuclear power facility emergency exercises. The Commission also has developed a program to have all applicable Commission staff trained in NIMS. The Commission is NIMS compliant for Fiscal Year 2008-09 and will continue to maintain compliance for future years as requirements are updated and staff changes.

The Commission also has in place a self-certification regulation that requires each regulated utility to certify in an annual filing that it has reviewed its physical security, cyber-security, emergency and business continuity plans, as well as conducted tests or drills of these plans. This regulation followed a recommendation from the PUC's investigative report on House Resolution 361.

Federal Stimulus Money

The American Recovery and Reinvestment Act of 2009 was signed into law on Feb. 17, 2009 providing funding and incentives, among other things, to improve the U. S. infrastructure. Specifically, funding was made available to improve electric delivery and reliability, energy efficiency, renewable energy, telecommunications broadband deployment, clean water, waste water and railroads. Pennsylvania expects to receive about $16 billion.

In April 15, 2009, the Commission expressed a strong interest in ensuring that funding available for Pennsylvania's utility infrastructure is identified, aggressively pursued and secured. To ensure that Pennsylvania receives the maximum benefits of the Act, the Commission offered to support grant applications for projects that will benefit our utility infrastructure. The Commission sent letters of support for several specific projects, including smart grid applications. The Commission also requested utilities and stakeholders to submit informational filings when federal stimulus funds are received.

On May 6, 2009, the Commission initiated an investigation into action that may be needed to ensure the Commonwealth's compliance with and eligibility for a portion of $3.1 billion in grants under the Federal State Energy Program. Those grants are contingent upon the states having general ratemaking policies which ensure that utility financial incentives are aligned with the promotion of energy efficiency and conservation. Comments filed by interested stakeholders are undergoing review. Further Commission action is expected in Fiscal Year 2009-10.

In June 2009, the Department of Energy announced a grant opportunity designed to provide financial assistance to state electric regulators, including the PUC. These funds are to be spent on new positions and training in connection with issues including energy efficiency, electricity-based renewable energy, energy storage, smart grid, demand response, and transmission. Funding is expected to be available during the 2009-10 fiscal year.

About $5 billion in economic stimulus money is dedicated to promoting broadband deployment and providing broadband service to "underserved" or "unserved" communities. The grants and loans are expected to be distributed within two years from the time ARRA was enacted in early 2009. In addition, millions of dollars will be distributed to states in support of broadband mapping efforts.

The Commission has worked with the Office of Administration (OA) in attempts to support proposals that seek grants and loans within Pennsylvania to promote broadband deployment and services. The Commission participated in review of provider proposals while also providing extensive technical assistance. The Commission also has provided technical assistance in support of mapping grant proposals.

The Commission continues to repeat Pennsylvania concerns about broadband deployment and services at the FCC in support of the OA efforts.

On Jan. 12, 2009, NTIA awarded DCED about $1.7 million in grants for broadband data collection and mapping activities over a two-year period and $500,000 for broadband planning activities over a five-year period in Pennsylvania. This brings the total grant award to approximately $2.2 million. DCED is the designated entity for doing mapping under the NTIA grant in Pennsylvania.

The Governor established a Stimulus Oversight Commission to review, monitor and advise PA's plans for stimulus spending to assure that citizens get the best from the program. The Oversight Commission's website is at www.recovery.pa.gov.

COMMISSION'S BUDGET

Executive Government Operations

General Government Fund	General Fund	General Fund
Rebudget	Actual Expenditures 2008-09	Approved Rebudget 2009-10
State Funds:		
Personnel	$42,446,000	$41,527,000
Operating	9,596,000	10,934,000
Fixed Assets	120,000	120,000
Total State Funds	**$52,162,000**	**$52,581,000**
Federal Funds:		
Personnel	$1,973,000	$2,421,000
Operating	591,000	968,000
Total Federal Funds	**$2,564,000**	**$3,389,000**
Total Commission Budget:	**$54,726,000**	**$55,970,000**

* Numbers may not total properly due to rounding.

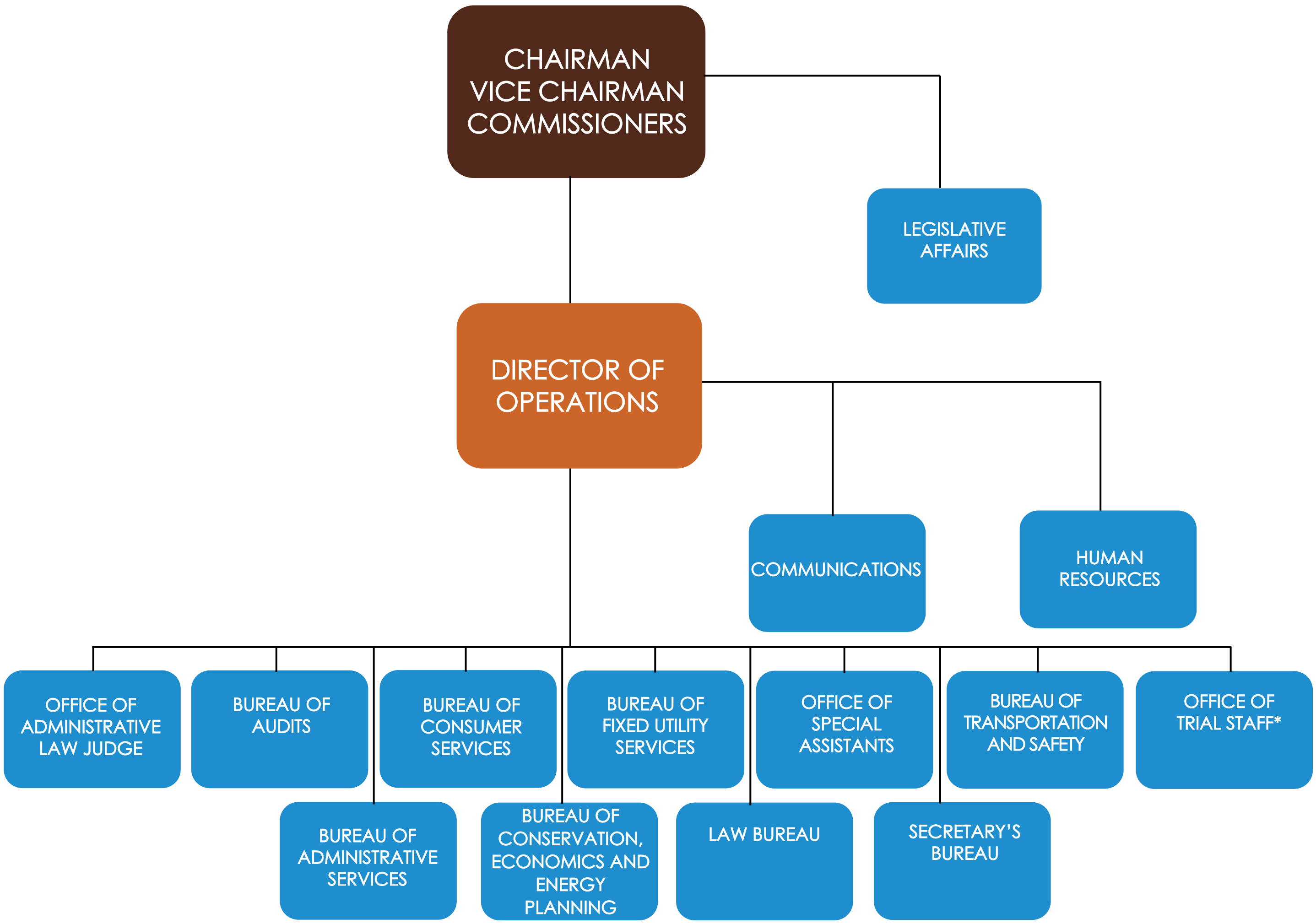
Other Revenue Sources

	2007-08 Receipts	2008-09 Receipts
Filing & Copy Fees	$207,434	$196,686
Electric Generation Application Fees	7,350	-
Fines	156,925	148,958
Federal - Gas Pipeline Safety	401,045	510,094
Federal - Motor Carrier (MCSAP)	526,414	818,718
Total	**$1,299,168**	**$1,674,456**

2008-09 Application Fees, Filing, Copy Fees & Fines

	Electric Generation Application Fees	Fines	Filing & Copy Fees	Total
1st Quarter	$ -	$9,375	$46,687	$56,062
2nd Quarter	-	38,390	46,444	84,834
3rd Quarter	-	30,068	47,150	77,218
4th Quarter	-	71,125	56,406	127,531
Total	**$ -**	**$148,958**	**$196,686**	**$345,644**

ORGANIZATIONAL CHART



*The Director of Operations has the responsibility for the Office of Trial Staff only with regard to administrative matters.

2008-09 BUREAU DIRECTORS

Office of the Director of Operations

The Director of Operations is responsible for the day-to-day administration and operation of the bureaus and offices within the Commission, including: goals and objectives; organizational structures; staff selection and training; performance standards; assignments to bureaus; and coordination of multi-bureau projects. The Office is comprised of the Director of Operations, administrative support staff, and the offices of Communications and Human Resources. The Office of Communications handles media relations, public outreach and employee communications. The Human Resources Office handles all personnel issues, and provides administrative and advisory services to all PUC management.

Bureau of Administrative Services

The Bureau of Administrative Services is responsible for the preparation of the Commission's budget, collection of assessments, various fiscal operations, processing of contracts, information and technology functions, and office services. The Bureau also provides support to the Director of Operations for administrative matters in the Commission's daily operation. Mail distribution, inventory control, automotive and travel-related services also are handled through this department. The Bureau is comprised of assessment, fiscal, management information and office services.

Karen Moury
Director of Operations

Tom Charles
Manager of Communications

Kevin Hoffman
Director of Human Resources

Robert C. Gramola
Director of Administrative Services

Veronica A. Smith
Chief Administrative Law Judge

M. Carl Lesney
Director of Audits

Wayne Williams
Director of Conservation, Economics and Energy Planning

Alexis Bechtel
Director of Consumer Services

Office of Administrative Law Judge

The Office of Administrative Law Judge fulfills a judicial role within the Commission by hearing cases, mediating cases through the alternative dispute resolution process and issuing decisions. Headed by a Chief Administrative Law Judge, the Office's primary duty is to provide fair and prompt resolution of contested proceedings before the Commission. The Administrative Law Judges (ALJs) are attorneys with experience in administrative law. They are independent judges who preside over the hearings in cases, which can include consumer complaints, rate filings, investigations, ability to pay/billing disputes and applications. ALJ decisions are based upon a record of evidence, legal precedent and policy.

Bureau of Audits

The Bureau of Audits performs financial, management and operational, and specialized audits on electric, natural gas, steam heat, water and telecommunications utilities, and reviews certain adjustment clause rate filings. The Bureau also conducts a limited number of reviews of the annual assessment reports for transportation companies. The audits may result in recommendations to refund over-recovered costs and/or to improve accounting or operational procedures that, if adopted, may save the utilities money, which may result in significant one-time savings for utilities or become annual savings. The Bureau also is responsible for auditing the annual reconciliation statements associated with stranded costs of electric distribution companies and certain water companies authorized to use the Distribution System Improvement Charge.

Bureau of Conservation, Economics and Energy Planning

As a research arm of the PUC, the Bureau of Conservation, Economics and Energy Planning studies and researches energy matters and advises the Commission of the results to assist in making policy decisions. The Bureau also prepares reports for the Commission, provides technical support for other bureaus and participates in working groups on energy issues. The Bureau monitors developments in the energy fields such as market-pricing trends, use of alternative energy resources, reliability, demand forecasts and the availability of supply to meet demand. The Bureau also provides oversight of energy efficiency, conservation, demand response and metering programs to assist customers in reducing their energy usage and managing their energy bills.

Bureau of Consumer Services

The Bureau of Consumer Services responds to and investigates informal complaints from residential and small commercial consumers. The Bureau also serves as a mediator between utilities and consumers, working to resolve complaints or develop payment arrangements. The Bureau provides consumers with utility-related information and monitors compliance with PUC regulations regarding consumers. The Bureau provides an analysis of utility performance when handling consumer complaints and issues.

Robert Wilson
Director of Fixed Utility Services

Bohdan R. Pankiw
Chief Counsel

June Perry
Director of Legislative Affairs

Bureau of Fixed Utility Services

The Bureau of Fixed Utility Services serves as an adviser to the PUC on technical issues for electric, natural gas, water and wastewater, and telecommunications utilities. The Bureau offers policy recommendations on rates, tariffs and regulatory matters, processes fixed utility applications, and coordinates emergency operations of utilities. The Bureau processes filings such as securities certificates and affiliated interest agreements. The Bureau also reviews and maintains county 911 system plans; telecommunications relay service reports; annual financial reports; and utility tariffs. The Director of the Bureau is vested with the authority to act for the Commission during emergencies and represents it on the Pennsylvania Emergency Management Council.

Law Bureau

The Law Bureau acts as the Commission's in-house legal counsel, providing legal advice to the Commission. The Bureau's director serves as Chief Counsel to the Commission. Three main categories of legal services are provided by the Bureau: advisory, representational and prosecutory/enforcement. The Law Bureau initiates both in-house prosecutions and enforcement proceedings against public utilities. During in-house prosecutions, the Bureau investigates and files complaints against utilities that fail to maintain adequate service or reliability, to obey Commission Orders or to comply with other regulatory obligations. During enforcement proceedings, the Bureau will file lawsuits in Commonwealth Court against utilities that fail to obey final PUC orders or court orders. The Law Bureau represents the Commission before state and federal courts when the Commission's decisions are challenged. The Bureau also represents the Commission before federal agencies such as the Federal Communications Commission or the Federal Energy Regulatory Commission on issues that impact Pennsylvania.

Office of Legislative Affairs

The Office of Legislative Affairs acts as the liaison between the PUC and the Governor's Office, the General Assembly and the Pennsylvania Congressional Delegation. The Office identifies legislation that may affect the Commission or public utilities and obtains staff analysis; provides bill analysis and relevant information to the legislature; and promotes the Commission's position on legislation and issues with the General Assembly. The Office also handles requests for information from the Governor, legislators and constituents.

James J. McNulty
Secretary

Cheryl Walker Davis
Director of Special Assistants

Mike Hoffman
Director of Transporatation and Safety

Johnnie Simms
Director of Trial Staff

Secretary's Bureau

The Secretary's Bureau is the PUC's official point of contact with the public. The Bureau receives all official documents and filings, serving as the prothonotary of the Commission. All official Commission actions and decisions are issued over the Secretary's signature. All correspondence and filings must be addressed to the Secretary to be considered filed before the Commission. The Bureau receives, enters, indexes and assigns all filings to appropriate bureaus through InfoMAP, which is the Commission's document and case management system. The Secretary's Bureau also is responsible for coordinating and monitoring all Public Meeting agendas and meeting minutes, and issuing all Commission Orders and Secretarial Letters.

Office of Special Assistants

As the Commission's advisory support bureau, the Office of Special Assistants is comprised of attorneys, rate case review specialists and administrative support staff. The Office drafts Opinions and Orders for the Commission to vote on at Public Meetings, as well as reviews and offers recommendations on the exceptions to Administrative Law Judge decisions, petitions for reconsideration and requests for extensions of filing deadlines. The Office also revises Opinions and Orders to be consistent with Commissioner motions adopted at Public Meetings.

Bureau of Transportation and Safety

Comprised of the Motor Carrier Services and Enforcement Division, the Rail Safety Division, and the Gas Safety Division, the Bureau of Transportation and Safety seeks to ensure safe and reliable natural gas, rail and motor carrier service throughout the state. The Bureau handles applications and rate filings of motor carriers; ensures compliance with PUC regulations; and inspects natural gas facilities and records to ensure compliance with state and federal requirements.

Office of Trial Staff

The Office of Trial Staff (OTS) represents the public interest in all matters having an impact on rates before the PUC. The Director is designated as the Commission's chief prosecutor, and the Office is made up of the administrative, legal and technical divisions. The Office of Trial Staff is responsible for reviewing Commission filings made by utilities involving rate-related matters. Additionally, the Director may petition the Commission or may be directed by the Commission to intervene to protect the public interest in proceedings having no impact on rates. Staff prepares and defends testimony in support of the public interest position in hearings before Commission administrative law judges, and engages in mediation sessions, alternative dispute resolution processes and settlement negotiations. Due to its prosecutory role, OTS works independently of the Commission.

CONSUMERS

The Commission remains committed to monitoring and evaluating utility performance, as well as working aggressively to educate consumers about critical utility issues, including significant price increases for energy and their rights as utilities consumers.

During Fiscal Year 2008-09, the Commission continued with the implementation of the changes to the utility termination rules while working to educate consumers about these changes and their rights. The Commission focused much of 2008-09 on educating electricity customers about rising energy prices and the resources available to help them. The PUC issued its biennial report on the implementation of the Responsible Utility Customer Protection Act (Chapter 14), as well as continued the rulemaking on Chapter 14 with the Standards and Billing Practices for Residential Utility Service (Chapter 56). The Commission also continued to expand its consumer outreach activities by participating in the Commonwealth's annual Farm Show, hosting regional events and visiting local communities.

Consumer Education on Electric Prices

Part of the Commission's policies to mitigate and prepare Pennsylvania electricity customers for significant price increases includes working with the electric utilities to implement utility-sponsored consumer-education plans for their service territories.

Each of the state's electric distribution companies (EDCs) under the PUC's jurisdiction filed a proposed consumer-education plan that is tailored to their service territory as required under a May 17, 2007, Commission Order that established policies to mitigate higher electricity prices.

The plans were to educate consumers about price increases while providing information on energy conservation and efficiency, demand side response, low-income programs, and electric competition. The plans also proposed appropriate budget levels and cost recovery mechanism. The intention is to prepare Pennsylvanians for removal of electric rate caps and to make informed decisions regarding their own levels of electric use. The Commission approved each of the plans after ensuring the plans met the requirements. Per each Commission order approving each EDC's plan, the Commission, the Office of Consumer Advocate and the Office of Small Business Advocate continue to review the consumer-education materials in fulfillment of each plan. The Commission also proposed a statewide campaign to prepare Pennsylvania electricity customers for post-rate cap prices through education on energy conservation, retail choice and low-income programs.

Each plan is posted to the PUC website under the Electricity tab. Click on Electric Price Mitigation.

Christina Chase-Pettis of the PUC's Office of Communications works to educate consumers on complex utility issues by making utility education fun through the use of games with seniors and other outreach techniques.

Consumer Outreach Summary

PUC Consumer Outreach Specialist Shari Williams, center, provides information for consumers about utility issues.

The PUC's consumer outreach specialists have provided utility education and outreach to thousands of consumers by working with health and human service providers, consumer advocates, utility community relations specialists, seniors and low-income consumers. The outreach team travels the state to ensure consumers from all socioeconomic backgrounds are educated and understand their rights as utility customers. In 2008, the outreach team hosted numerous workshop events, free seminars and roundtable discussions throughout the state. Outreach specialists also support and participate in community fairs, legislative forums, senior expos, public input hearings and other educational events.

During those events, materials are provided to consumers about complex utility issues, including fact sheets outlining the Responsible Utility Customer Protection Act; customer assistance programs; energy efficiency and conservation tips; transmission line siting; and rising energy prices.

The outreach specialists are committed to assisting consumers in addressing their specific individual concerns and offering solutions to utility-related issues. In 2008, the team focused on educating Pennsylvanians and non-profit, community-based organizations through the PUC's "Prepare Now" campaign in conjunction with Gov. Rendell's "Stay Warm/Turn Down. Seal Off. Save Up." campaign, "Be Utility Wise" and "Know What's Below. Call Before You Dig" initiatives.

In Spring 2009, the consumer outreach specialists staffed a series of public input meetings regarding the Federal Broadband Stimulus Program within the American Recovery and Reinvestment Act. They participated in the Q&A session, and distributed Bona Fide Retail Request brochures.

Overall messages encouraged consumers to:

- Use electricity, natural gas and water wisely to potentially save money. Consumers were given informational materials and fact sheets providing conservation tips on how to become more responsible and aware of their utility usage.
- Know their rights as responsible utility consumers and be aware of important changes in the law related to utility shut-offs (Chapter 14).
- Consider budget billing options as a way to make heating bills more predictable and affordable throughout the year.
- Utilize the national 8-1-1 number to "Know What's Below. Call Before You Dig" to create safety awareness of underground utility lines.

New partnerships and networking opportunities were developed by attending training sessions and informational meetings with other state agencies and community-based organizations.

PA Farm Show

In January 2009, the Commission participated in the 93rd Annual Farm Show, to inform its more than 400,000 visitors about the role of the PUC as an available resource to address utility questions or concerns.

The PUC booth contained information about energy, telephone, transportation, water and wastewater issues. The Commission's primary focus was to educate consumers to prepare now for higher energy costs, and provide tips

Pennsylvania Farm Show 2009

for weatherizing homes and conserving energy. Electricity rate caps were also a popular topic raised by Farm Show visitors.

Information also was available on:

• Programs to help low-income consumers pay utility bills.

• How consumers can take advantage of the Alternative Energy Portfolio Standards Act of 2004.

• Act 183 of 2004, which requires telecommunications companies to provide access to high-speed Internet by 2015.

• Telecommunications Relay Service (TRS), which enables Pennsylvanians to communicate by telephone with people who are deaf, hard of hearing or speech disabled (*See Telephone*).

Customer Assistance Program Review

In August 2007, the Commission issued for comment a proposed rulemaking and policy statement revisions that address Customer Assistance Programs (CAPs), under which low-income customers receive financial assistance in paying utility bills. The action was part of the Commission's comprehensive examination of universal service programs.

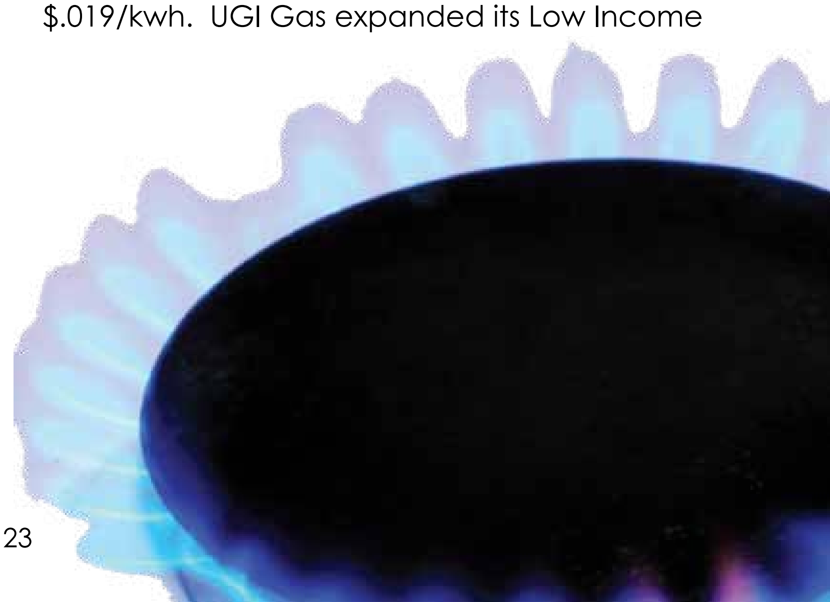
The Commission has received comments from interested parties on both the proposed rulemaking and policy statement. The comments are being reviewed as the rulemaking and policy statement move toward being finalized.

In considering CAP design, funding and cost recovery simultaneously, the Commission's goal is to balance the interests of the low-income customers who participate in CAPs with interests of all residential ratepayers. The state's electric and natural gas competition laws require that every electric utility and major natural gas utility establish a CAP. The funding levels and program design vary from company to company.

UGI and UGI Penn Expand Low-Income Programs

In December 2008, PUC Commissioners approved a plan for the electric and natural gas divisions of UGI Utilities Inc. and UGI Penn Natural Gas Inc. to expand low-income programs to accommodate more customers. The companies are permitted to increase enrollment in their Customer Assistance Programs (CAPs) and make changes to the funding mechanisms.

UGI Electric expanded its CAP from 1,100 to 2,500 customers as a result of a CAP rider on residential bills of $.0018/kwh. UGI Penn expanded its CAP from 5,000 to 6,000 customers as a result of a CAP rider on residential bills of $.019/kwh. UGI Gas expanded its Low Income



Self-Help Program (LISHIP) from 8,000 to 10,000 customers as a result of an increase in its LISHIP rider on residential bills of $.02/Mcf.

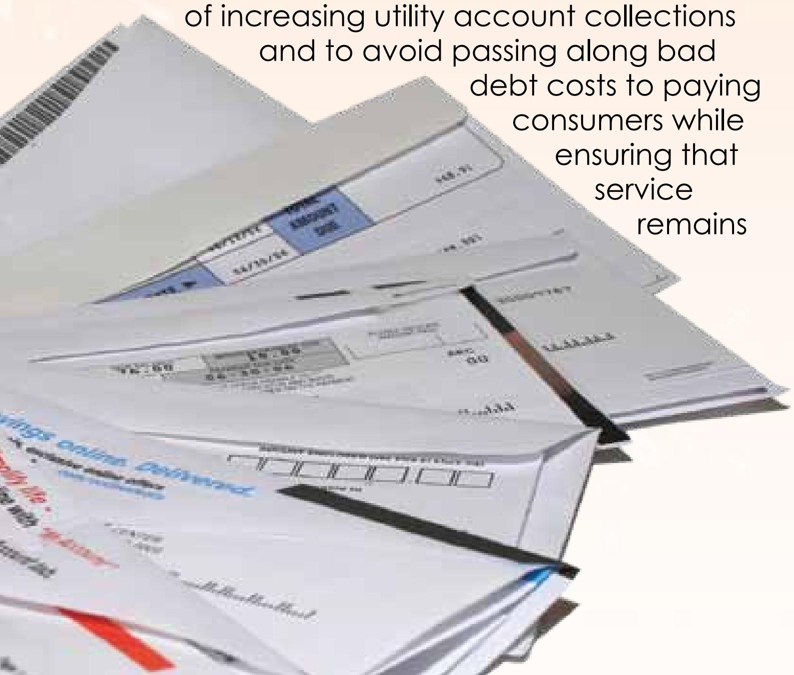
In October 2008, PUC Commissioners approved revisions to UGI Penn's CAP, which consolidated the customer information systems for UGI Utilities and UGI Penn, and took the information system out of service in January 2009. The Low Income Usage Reduction Program (LIURP), Customer Assistance and Referral Evaluation Services (CARES), and the Hardship Fund, known as Project Outreach, were not affected by this change since a separate information system is used for these programs.

Chapter 14 Impact Report

On Dec. 15, 2008, the Commission issued its second biennial report on the implementation of Chapter 14, which was added to the Public Utility Code under the Responsible Utility Customer Protection Act of 2004.

Chapter 14 seeks to eliminate the opportunities for customers capable of paying their utility bills to avoid doing so, and to provide utilities with the means to reduce their uncollectible accounts. The law changed the way regulated electric, water and major natural gas utilities handle cash deposits; termination of service; reconnection of service; payment arrangements; and the filing of termination complaints by residential customers.

The Commission is striving to implement Chapter 14 in a manner that achieves the policy goals of increasing utility account collections and to avoid passing along bad debt costs to paying consumers while ensuring that service remains available to all consumers on reasonable terms and conditions. The Commission is dedicated to using a collaborative process that accounts for the needs of both utilities and consumers, and gives all parties an opportunity to participate.



Upon release of the report, the PUC provided recommended amendments regarding continued support for the federally funded Low-Income Home Energy Assistance Program (LIHEAP). The Commission asked the General Assembly to consider introducing legislation to direct additional state dollars to assist low-income households and that an energy emergency be declared releasing such funds for 2008-09.

The Commission is required to submit a biennial report to the Governor and legislature updating the effects of implementing Chapter 14. All reports are available on the Commission's website under Publications and Reports. The next report will be issued in Fiscal Year 2010-11.

Prepare Now

During Fiscal Year 2008-09, the PUC urged electric and natural gas utilities to take extra steps to help consumers to "Prepare Now" for the higher costs of winter heating.

The Commission's "Prepare Now" outreach campaign appeals to consumers on limited or fixed incomes to call their utility about special programs such as CAP and LIURP to help heat their homes and pay their energy bills. This year, the "Prepare Now" campaign worked in conjunction with Gov. Rendell's "Turn Down. Seal Off. Save Up."

In September 2008, the five PUC Commissioners kicked off the annual "Prepare Now" campaign with an en banc hearing which solicited comments on rising energy prices, reducing energy usuage and the availability of low-income programs from the Department of Environmental Protection, the Energy Association of Pennsylvania, the PA Home Energy Program, the Keystone Help Loan Program, the PUC Consumer Advisory Council and several other groups. The "Prepare Now" campaign urges customers to know their rights and how regulated electric, water and major natural gas utilities must handle cash deposits; reconnection of service; termination of service; payment arrangements; and the filing of termination complaints by residential customers.

In an October 2008 letter, the Commission asked electric and natural gas utilities under its jurisdiction to join the PUC in reaching out and educating consumers. The letter also stressed the importance of the LIHEAP and the impact the program has on helping low-income consumers restore and maintain service. In addition, the letter reminded the utilities of their responsibilities under the state's utility termination and reconnection law, also known as Chapter 14. In January 2009, the PUC reminded consumers at risk of termination to call their utility to seek resources to help maintain electric or natural gas utility service for the winter.

It was the sixth winter in which the Commission urged consumers to "Prepare Now." The message is simple: "Prepare Now" for higher energy costs this winter. Learn about changes in the law related to utility shut-offs and know your rights. Save money by learning how to conserve energy. Heat your home safely. Explore budget billing options. Look into programs that help low-income customers restore and maintain service. Visit www.puc.state.pa.us, and click on "Prepare Now" or call the PUC at 1-800-692-7380.

Turn Down. Seal Off. Save Up.

In October 2008, the Commission joined a statewide summit of local government, community, religious, labor and volunteer leaders to develop strategies to help Pennsylvanians stretch their heating resources so that they can stay warm throughout the winter as part of the Governor's "Stay Warm PA" initiative. As part of the initiative, the five Commissioners participated in the "Turn Down. Seal Off. Save Up." campaign.
Such involvement included regional meetings in York, Pittsburgh, Philadelphia, Erie and the Lehigh Valley to educate consumers on energy conservation. The goal was to encourage residents to turn down their thermostats and seal off drafts to save as much as $740 in annual heating costs.

The Commissioners also attended various summits with state legislators and community leaders across Pennsylvania to discuss action plans for educating consumers on energy conservation. Various events were held in Bucks, Butler, Chester and Delaware counties throughout the winter months.

For more information, visit www.turnsealsave.org.

Settlements with Utility Companies

In Fiscal Year 2008-09, the PUC approved settlements with utility companies following informal investigations into violations of the Public Utility Code or consumer complaints. In many cases, the companies agreed to improve communications with consumers.

Metropolitan Edison Co. (Met-Ed) paid a $25,000 civil penalty and was ordered to develop a plan to either maintain or remove transmission facilities. The decision came in response to two formal complaints alleging that Med-Ed failed to maintain the lines for at least 20 years and that the lines created a safety hazard.

PPL Electric Utilities Corp. (PPL) contributed $300,000 to Operation Help, a fund that provides emergency financial aid to pay heating bills for families with financial hardships. The settlement ended an informal investigation into an electric service termination that preceded a fatal fire that claimed the lives of two children. Under the settlement, PPL also will develop updated call scripts; increase training for its customer service representatives; establish procedures to assist customers seeking payment arrangements; and enhance procedures for handling customers whose service is terminated on Fridays.

Pennsylvania Electric Co. (Penelec) contributed $200,000 to the Dollar Energy Fund, a non-profit organization that provides financial assistance to customers who are on a low or fixed income. The settlement ended an informal investigation into an electric termination that preceded a fire that seriously injured an occupant. Under the settlement, Penelec also will transfer account balances in a consistent manner; issue "Dear Occupant" letters in a timely manner; comply with notice requirements; not require a notarized lease, deed or mortgage documents of applicants for service; not require proof of residency to begin service at a residence; and communicate a specific timeframe in which an applicant has to comply with the requirements for service.

Pike County Light and Power Co. (PCL&P) will pay $35,300 to The Neighbor Fund to help low-income PCL&P customers with their bills. The settlement ended an informal investigation into a system billing error that resulted in incorrect bills for 353 customers. The PUC's prosecutory staff found that the company overbilled 273 non-residential customers 2.6 times per year by a total of $67,967, and underbilled 80 customers by a total of $34,834. Upon discovery of the programming error, PCL&P identified all affected customers, recalculated all over-billings and credited each customer's bill in the amount of the over-billing plus interest.

Pennsylvania American Water Co. (PAWC) paid a $3,000 civil penalty and individual restitution payments to affected customers in a termination of services case. The Commission staff began an informal investigation into the company's alleged failure to provide the required statutory notices of termination at least three days prior to the scheduled terminations of service. Also under the settlement, PAWC will begin a "spot check" process to ensure that the correct number of attempts is made prior to a termination of service, and will also begin quality analysis and additional training.

UGI Utilities Inc. paid a $15,000 civil penalty regarding a consumer being billed for natural gas usage for which she was not responsible. The settlement ends an informal investigation that UGI allegedly failed to investigate natural gas usage at a location where the service had been shut off; to recognize a payment dispute; to follow proper payment dispute procedures; and to enter into a proper payment arrangement. Under the settlement, the company will also prepare a comprehensive training manual and procedures for its Revenue Protection Unit and retrain its Revenue Protection Unit employees.

Columbia Gas of Pennsylvania Inc. (Columbia Gas) paid $572,862 to its residential Hardship Fund that provides financial assistance through grants to low-income, payment-troubled customers and $196,080 to small commercial customers. An agreement approved by the Federal Energy Regulatory Commission provided that Columbia's affiliates, Columbia Gas Transmission and Columbia Gulf Transmission Corporation (TCO), will give $9 million of profits to customers, because those profits were made through illegally provided parking and lending services.

Philadelphia Gas Works (PGW) paid $10,000 to the company's pilot conservation program that provides extensive services, including heating system replacements for low-income customers. The settlement ended an informal investigation into alleged violations of the Public Utility Code and the company's tariff. Under the settlement, PGW will also provide classroom and additional training for its customer service representatives. PGW also must provide quarterly updates to the PUC on its training efforts.

Cold Weather Survey Results

Each year, prior to the winter heating season, the PUC requires electric and natural gas utilities to check residential properties where service has been terminated due to non-payment. The goal of the annual Cold Weather Survey is for the company to attempt to reach payment agreements with the occupants so service can be restored.

The Commission requests that utilities make four attempts to contact the consumer or a responsible adult occupant at the property where service has been terminated. These contacts include a combination of telephone calls and letters to establish contact, with the fourth attempt being a personal visit to the property.

In December 2008, the survey found that 14,372 occupied households were without heat-related utility service. An additional 3,373 homes were using unsafe heating sources, bringing the total homes not using a central heating system to 17,745. The total number was 16,857 in 2007.

Residential electric households not using a central heating system totaled 4,106, while 13,639 natural gas households had no service. About 8,803 households – 50 percent of the total accounts without service – were in the Philadelphia area. The results also showed that an additional 20,037 residences where services were terminated appeared to be vacant.

The companies resurveyed the households without utility service in February 2009. At that time, the total number of homes not using a central heating system decreased by 36 percent to 11,347.

Universal Service Collection Data

The PUC issued the 2008 annual summary of the universal service programs and collections performance of each of the state's major electric distribution companies (EDCs) and natural gas distribution companies (NGDCs) in Fiscal Year 2008-09.

Universal service programs are designed to help ensure that all customers have access to utility service no matter what their income. Programs include the Low Income Usage Reduction Program (LIURP), Customer Assistance Programs (CAPs), Customer Assistance and Referral Evaluation Services (CARES), and Hardship Funds.

Generally, electric and natural gas customer households that are enrolled in universal service programs have average household incomes that are less than $16,700 a year.

According to the report, the gross write-offs ratio for the electric industry was 1.85 percent in 2008, compared to 2.04 percent in 2007, while the natural gas industry average was 3.52 percent in 2008 and 4.10 percent in 2007.

EDCs used $189,171,318 to enroll 240,002 customers in CAPs where on average those customers pay 79 percent of their total bill.

NGDCs used $174,497,927 to enroll 179,958 customers in CAPs where on average those customers pay 87 percent of their total bill, according to the report.

EDC customers also received $21.6 million in Low Income Usage Reduction Program (LIURP) benefits while NGDC customers received $8.9 million in LIURP benefits, according to the report. The full report is available on the PUC website at www.puc.state.pa.us under Publications and Reports.

Utility Consumer Activities Report and Evaluation

Helping Pennsylvania consumers resolve utility problems remains a major concern for the Commission. Full-time investigators within the PUC's Bureau of Consumer Services (BCS) handle a variety of consumer contacts related to billing problems, service delivery and repairs. The 2007 Utility Consumer Activities Report and Evaluation (UCARE) shows that BCS investigated 20,596 consumer complaints in 2007, with 18,388 of those complaints coming from residential consumers and 2,208 from commercial consumers. This represents a decrease of 3 percent for total consumer complaints and a 5 percent decrease for residential consumer complaints from 2006.

BCS also handled 50,170 requests for payment arrangements from residential customers in 2007, a 3 percent increase from 2006. The majority of requests for payment arrangements – 44,300 requests – involved electric or natural gas companies. In addition, 1,690 residential telephone consumers requested assistance in setting up payment arrangements in 2007, which is a 20 percent decrease from the number of payment arrangements requested in 2006.

Terminations of electric and natural gas service increased from 2006 to 2007. Statewide, electric and natural gas terminations went from 224,199 in 2006 to 244,943 in 2007 – a 9 percent increase. Likewise, reconnections of electric and natural gas service increased during the same period, going from 147,805 in 2006 to 173,607 in 2007 – a 17 percent increase.

At this time, water utilities are not required to report termination and reconnection data to the Commission, so BCS does not report this data in the UCARE report.

However, Aqua Pennsylvania and Pennsylvania American Water Co. (PAWC) have voluntarily provided termination data to the Commission. Terminations for these companies increased from 26,424 in 2006 to 27,731 in 2007 – a 5 percent increase. Likewise, reconnections for Aqua and PAWC increased during the same period from 19,732 in 2006 to 20,967 in 2007 – a 6 percent increase. Since Chapter 14 applies to electric, gas and water companies, termination and reconnection data from these water companies is important information for the Commission.

BCS also received 79,341 inquiries in 2007, a 13 percent increase from the previous year. Inquiries include information requests, requests for payment arrangements that BCS cannot accommodate and opinions from consumers. For the most part, these contacts did not require investigation by BCS. These inquiries came to the attention of BCS through the Commission's toll-free hotlines, other telephone numbers, the U.S. Postal Service and e-mail communication.

The PUC surveys consumers who have contacted BCS with a utility-related problem or payment arrangement request in order to monitor its own customer service. The 2007 survey results show that more than 89 percent of consumers said they would contact the PUC again if they were unable to resolve their problem by talking with the utility. Meanwhile, 81 percent of consumers rated the service they received from the PUC as "good" or "excellent."

This and other data appear in the Commission's 2007 UCARE report, which is available on the Commission's website at www.puc.state.pa.us under Publications and Reports.

Customer Service Performance Report

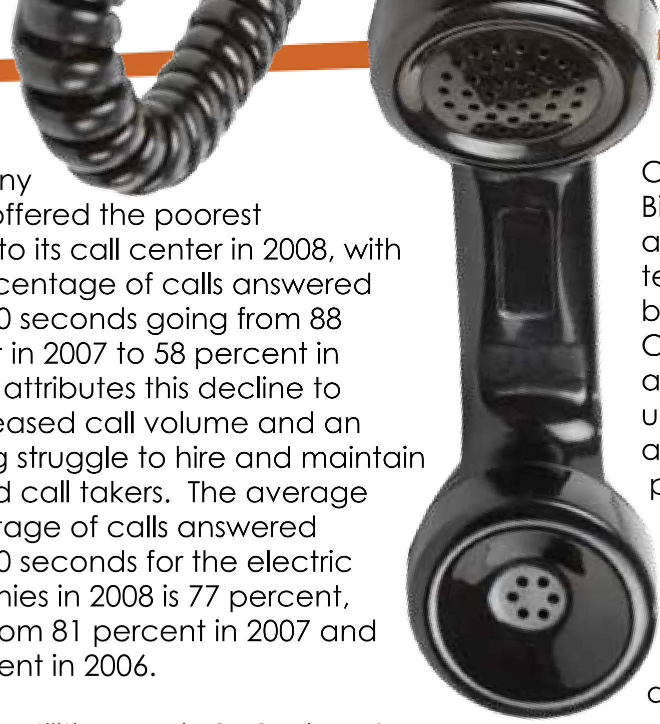
Each year, the Commission prepares the Customer Service Performance Report. In addition to reporting company submitted data, the report provides information on how customers feel the major electric and natural gas companies are doing with customer service.

In 2008, the majority of electric and natural gas customers contacted said they were satisfied with the way company customer service representatives handled their calls.

Based on customer surveys, an average of 88 percent of electric and 78 percent of natural gas customers said they were satisfied with the ease of reaching their company. A greater percentage of customers said they were satisfied with the way company representatives handled their calls – 91 percent of electric customers and 87 percent of natural gas customers. A majority of the customers were satisfied with both the courtesy and level of knowledge demonstrated by customer service representatives.

The report also includes data provided by the utilities on the performance of the company's customer service operations. Three electric companies reported that their call abandonment rate went up from the previous year, indicating a decline in performance in this area. One improved and two remained the same as the previous year. Abandoned calls are the number of customers who hang up while on hold to speak to a representative.

The average call abandonment rate of almost 7 percent for the natural gas companies is nearly twice that of the electric companies. Four of the major electric companies reported an improvement in the percentage of calls answered within 30 seconds, while two reported a decline.



Allegheny Power offered the poorest access to its call center in 2008, with the percentage of calls answered within 30 seconds going from 88 percent in 2007 to 58 percent in 2008. It attributes this decline to an increased call volume and an ongoing struggle to hire and maintain qualified call takers. The average percentage of calls answered within 30 seconds for the electric companies in 2008 is 77 percent, down from 81 percent in 2007 and 80 percent in 2006.

UGI-Gas Utilities Inc. (UGI-Gas) and Philadelphia Gas Works Co. (PGW) reported significant improvement in the percentage of calls answered within 30 seconds. UGI answered 87 percent of its calls within 30 seconds in 2008, the highest percent of all the gas companies and better than the 80 percent reported for 2007. PGW also demonstrated a positive trend answering 55 percent of calls within 30 seconds in 2008, better than its 42 percent in 2007. The other five major natural gas companies all declined in the percentage of calls answered within 30 seconds. The average percentage of calls answered within 30 seconds for natural gas companies decreased from 73 percent in 2007 to 72 percent in 2008.

The full report for 2008 is available on the PUC's website at www.puc.state.pa.us under Publications and Reports.

Chapter 56/Chapter 14 Rulemaking

In September 2008, the Commission adopted a Notice of Proposed Rulemaking that will amend 52 Pa. Code Chapter 56 to bring it into compliance with Act 201 of 2004 (Chapter 14 of Title 66). In March 2009, the PUC issued a Secretarial Letter to direct those utilities that had already adopted electronic billing programs to file comments regarding the successes and failures of their individual electronic billing programs.

Chapter 56 contains the Standards and Billing Practices for Residential Utility Service, and includes the regulations governing the termination process, credit, applications, billing, payment and dispute procedures. The Commission also will use this opportunity to address other issues with Chapter 56, including updates needed due to technological advances, including electronic billing and payments.

The PUC received comments from all parties which are available on the Commission's website under Consumer Education. Such information is being reviewed by the PUC as it develops final regulations.

Consumer Advisory Council

The Consumer Advisory Council (CAC) was created through a regulation in 1977 to advise the Commission on matters relating to the protection of consumer interests under the Commission's jurisdiction. CAC members are appointed by the following elected officials: the Governor; Lieutenant Governor; the Democratic and Republican Chairpersons of the Senate Consumer Protection and Professional Licensure Committee; and the Democratic and Republican Chairpersons of the House Consumer Affairs Committee.

In addition, the Commission appoints "at-large" representatives that reflect a reasonable geographic representation of the Commonwealth, including low-income individuals, members of minority groups and various consumers. A person may not serve as a member of the Council if the individual occupies an official relation to a public utility or holds or is a candidate for a paid appointive or elective office of the Commonwealth. Council members serve two-year terms and may be reappointed. Council officers serve two-year terms. The Chairperson may not act for more than two consecutive terms.

The Council acts as a source of information and advice for the Commissioners. Interactions between the Council and the Commissioners

PUC Consumer Advisory Council: Front row, left to right: Tim Hennessey, John Detman, Lillian Carpenter, Dan Paul and Linda Roth. Back row, left to right: Joe Toner, Rick Hicks, Pedro Anes, Tom LeCrone, Tina Serafini, Tom Leach, Robert Christianson, George Silvestri and Lee Tolbert.

occur through periodic meetings, and in writing via minutes of meetings and formal motions. Council meetings are generally held at 10 a.m. on the fourth Tuesday of the month in the PUC Executive Chambers in Harrisburg. The meetings are open to the public.

In this fiscal year, the CAC continued to focus on issues arising from the restructuring of the electric, gas and telecommunications industries, the passage of Act 201 of 2004, the Chapter 56 rulemaking and universal service programs.

The Council also received briefings on issues that the Commission has dealt with, including Chapter 14, Chapter 30, Chapter 56, Cold Weather Survey, CAP policy, the legislative special session on energy, transmission lines, universal service, InfoMAP and the Alternative Energy Portfolio Standards Act.

PA Relay Service Advisory Board

In May 1990, the Commission established the Pennsylvania Relay Service Advisory Board. The purpose of the board is to review the success of the statewide Telecommunications Relay Service (TRS) and identify improvements that should be implemented. The board functions primarily as a TRS consumer group by providing feedback and guidance to the TRS providers and the Commission regarding communication assistant training, problem solving, outreach initiatives and service enhancements.

The board meets four times a year to advise the TRS providers on service issues, to discuss policy issues related to traditional TRS and Captioned Telephone Relay Service (CTRS), and to interact with Commission-appointed members. At each meeting, the traditional TRS provider and CTRS administrator give the board a status report of their activities. These reports include call volumes, new service offerings, complaint handling equipment enhancements and outreach plans.

The 12 members of the board are appointed by the Commission and serve two-year terms. The Commission requires that the board consists of one representative from the Pennsylvania Telephone Association, the Office for the Deaf and Hard of Hearing (ODHH), and the traditional TRS provider (AT&T of Pennsylvania); two representatives from the Commission; and seven representatives from the deaf, hard-of-hearing and speech-disabled communities.

During 2009, board members from the deaf, hard-of-hearing and speech-disabled communities included representatives from the following organizations: the Hearing Loss Association of Pennsylvania; the Pennsylvania Society for Advancement of the Deaf; the Center for Independent Living of South Central Pennsylvania; Independent Living Program at the Western Pennsylvania School for the Deaf; and the Office for the Deaf & Hard of Hearing.

As a user group, the board meeting agenda items are primarily related to quality of service and improving relay service. However, the board also has advised the Commission on many critical policy issues that affect TRS users.

Pennsylvania Relay Service Advisory Board: Front Row, left to right: Leslie Kelly, Pat Brockley, Carol Pennington and Kristen Brandt. Back row, left to right: Christa Cervantes, Lenora Best, Sharon Behun, Eric Jeschke, Chuck Hafferman, Robert Davis and Todd Behanna. Steve Samara not pictured.

Although the official consumer-education campaign to educate Pennsylvanians about the Telecommunications Relay Service has concluded, the Commission continues to work to educate consumers. Educators inform the hearing public about relay technology and enhance the opportunities of people with hearing loss and speech disabilities to communicate with the hearing public in their daily lives. They regularly provide TRS information and materials as they travel throughout the Commonwealth visiting numerous county fairs, festivals and other venues with large audiences.

“Know What’s Below.” “Call Before You Dig.” Dial 8-1-1.

During the height of summer construction season and with backyard projects in full swing, the PUC and Pennsylvania One Call System Inc. (PA One Call) reminded Pennsylvanians of the abbreviated dialing system of 8-1-1 to make certain underground utilities are marked before digging begins.

The PUC and PA One Call joined again to raise awareness about 8-1-1 safety. They participated in three 8-1-1 Safety Days: the Western PA Safety Day in September, the Eastern PA Safety Day in May and the Central PA Safety Day in June. In Pennsylvania, homeowners and contractors are required by law to call 8-1-1 at least three business days before using power equipment to make certain underground utility lines are marked.

The PUC provided the regulatory support needed to allow Pennsylvania to join the nation with 8-1-1 abbreviated dialing. In 2006, the PUC ordered all local telecommunications exchange carriers and other carriers with switching capabilities – including payphone providers – to fully implement 8-1-1 as the abbreviated dialing code to access PA One Call.

An informational brochure on the “Know What’s Below. Call 8-1-1 Before You Dig” campaign is available on the PUC website under the Consumer Education link.

Keystone Connection

The Commission continued its publication of the “Keystone Connection,” a newsletter that is released quarterly to about 1,200 subscribers, including news media and industry stakeholders. “Keystone Connection” provides a snapshot view of the utility markets under the jurisdiction of the Commission: electric, natural gas, transportation, telecommunications and water, highlighting the major issues that affect each industry. The publication contains coverage of all utilities, including news on consumer issues and general information on PUC happenings. Copies of the Keystone Connection are available on the PUC website at www.puc.state.pa.us under Publications and Reports.

ELECTRIC

The PUC regulates default service and distribution rates, ensures service reliability, and fosters the development of competitive electricity markets. The PUC participates in matters that impact the wholesale energy market. The PUC also regulates electric rates of some municipal systems that serve customers outside their boundaries. Since the implementation of Act 129 of 2008, the PUC reviews and approves energy efficiency and demand side response programs proposed by Pennsylvania's seven major electric utility companies.

The pending expiration of long-term electric generation rate caps coupled with the implementation of Act 129 and its comprehensive energy efficiency and conservation measures will change the way Pennsylvanians think about electricity consumption – an impact that is sure to be felt for years to come. While rate caps have expired in some portions of Pennsylvania, most consumers continue to receive electric service under capped generation rates, which expire at the end of 2009 and 2010. Currently, Pennsylvania has 11 electric distribution companies (EDCs) and 47 licensed electric generation suppliers (EGSs).

In Fiscal Year 2008-09, the Commission continued to move forward with efforts to mitigate the effects of rate cap expiration with a focus on developing strategies to remove barriers to competition; approving pre-pay or deferral programs after directing all electric utilities to file such plans if anticipated increases will exceed 25 percent; updating low-income programs that provide customer assistance; and implementing default service plans that reflect the least cost to consumers over the long term. The Commission's default service regulations and policy statement provide both guidance to the industry and suggested tools to mitigate the impact on consumers of transitioning from capped rates for generation to rates based on wholesale market prices.

The main goal of Act 129 is to reduce energy consumption and peak demand throughout Pennsylvania. The Commission is working to implement this groundbreaking legislation in phases to meet the deadlines on its accelerated timetable.

As the majority of the state's electric consumers transition to uncapped generation rates, the wholesale energy market rules continue to grow in importance. With that, the Commission has been increasingly focused on the effect of wholesale energy prices on retail electric rates, default service procurement practices, energy conservation, alternative energy and consumer education. Because a properly functioning and competitive wholesale market for electricity is essential for reasonable retail rates, the Commission has participated vigorously in proceedings before the Federal Energy Regulatory Commission (FERC) to represent the interests of Pennsylvania consumers in terms of market structure, reasonable prices and network reliability.

Act 129 of 2008 Implementation

As part of its special session on energy, the General Assembly adopted House Bill 2200. On Oct. 15, 2008, Gov. Rendell signed it into law as Act 129 of 2008. The PUC is actively involved in implementing Act 129, which expands the Commission's oversight responsibilities and imposes new requirements on EDCs, with the overall goal of reducing energy consumption and demand. Under Act 129, the state's seven largest EDCs must reduce electricity consumption by 1 percent by May 31, 2011, and 3 percent by May 31, 2013. The Act also requires a 4.5 percent reduction in peak demand by May 31, 2013.

Other goals of Act 129 include deploying smart meter technology and time-of-use rates, modifying default service procurement strategies, and expanding the types of generating plants that qualify as Tier I alternative energy sources. The efforts under Act 129 should ultimately reduce the cost of electricity, and enhance safety and reliability of service.

The implementation of Act 129 is one of the most pressing responsibilities currently before the PUC. In November 2008, the Commission held a special hearing to solicit input on the policy direction and issues related to alternative energy resources, energy conservation and efficiency, and demand side response tools. This hearing was critical as the Commission prepared to quickly implement the law.

Throughout the implementation process, the PUC has provided the opportunity for stakeholders to take an active role. The Commission has engaged consumer advocates, energy efficiency and conservation experts, EDCs, customers, electric generation suppliers EGSs and other interested groups, providing various opportunities for stakeholder comment in every aspect of the implementation of Act 129. To date, more than 50 interested parties have participated in various phases as we move through the implementation process.

In Fiscal Year 2008-09, the PUC met all of the implementation deadlines set forth in Act 129 and is moving swiftly to enact the remaining portions that were without deadlines. Implementation steps included:

- Establishing the criteria for EDC energy efficiency and conservation plans (EE&C), which were to be submitted to the Commission by July 1, 2009. All of the plans were submitted in a timely fashion. The Commission then had 120 days to complete a review of the plans. The initial EE&C plan reviews will be completed in the second quarter of Fiscal Year 2009-10.

- Identifying specific energy consumption and peak demand reductions that the EDCs must achieve under the Act. The energy consumption reductions total 1.5 million MWh by May 31, 2011 and 4.4 million MWh by May 31, 2013. The peak demand reduction is 1,193 MW by May 31, 2013.

- Creating a statewide registry for Conservation Service Providers (CSPs) that included the minimum experience and qualifications necessary to qualify as a CSP. Each EE&C plan must include a contract with one or more CSPs to implement the plan or a portion of the plan.

- Establishing smart meter technology procurement standards, including the minimum smart meter capabilities, guidance on deployment of smart meter technology, requirements for cost data and a timeline for implementation of the EDC plans. EDC plans were to be submitted to the PUC by Aug. 14. 2009.

- Entering into a partnership with GDS Associates Inc. Engineers and Consultants to provide long-term, statewide evaluation of the EDC energy efficiency programs.

- Adopting a total resource cost test to analyze the costs and benefits of the EE&C plans.

- Updating the Technical Reference Manual, which is used to assess energy savings attributable to energy efficiency and demand response measures for Act 129, as well as the Alternative Energy Portfolio Standards Act.

The PUC has dedicated a section of the Commission's website to Act 129 information – under the Electricity tab, select Act 129 Information to view copies of all Orders, Secretarial Letters, comments and reply comments, and EE&C plan submissions.

Rate Caps

Under the 1997 Electricity Generation Choice and Competition Act, electric rates - which are comprised of generation, transmission and distribution - were capped to ease the transition to competitive markets. The law provides a framework that allows all retail electric customers to have direct access to competitive suppliers of electricity.

The 1997 law allowed residential customers to purchase power from competitive EGSs, while still having their electricity physically delivered by the EDCs regulated by the PUC. The law also permitted the EDCs to recover "stranded costs," which were the existing investments in infrastructure that may have become uneconomic and unrecoverable in a competitive environment. The EDCs were permitted to recover those investments.

In exchange, generation, transmission and distribution rates were capped at the 1996 level. The caps on transmission and distribution rates all have expired. Through the settlement of litigated proceedings before the PUC, the generation rates were extended for many of the EDCs. As determined by those proceedings, all utility rate caps will expire by Jan. 1, 2011.

Company	Generation Rate Cap Status	% of PA Ratepayers
Citizens Electric Co.	Expired	0.1
Duquesne Light Co.	Expired	10.6
Pennsylvania Power Co.	Expired	2.8
Pike County Light & Power Co.	Expired	0.1
UGI Utilities Inc.	Expired	1.1
Wellsboro Electric Co.	Expired	0.1
PPL Electric Utilities Inc.	Dec. 31, 2009	24.6
Metropolitan-Edison Co.	Dec. 31, 2010	9.5
Pennsylvania Electric Co.	Dec. 31, 2010	10.6
PECO Energy Co.	Dec. 31, 2010	27.8
West Penn Power Co.	Dec. 31, 2010	12.7

The PUC expects that customers may see an increase in their bills after the expiration of rate caps. While Pennsylvania consumers' rates have been capped, the market prices for electricity have risen. The magnitude of those increases will depend upon market prices when the EDC acquires its power.

On Aug. 8, 2008, the Commission began releasing quarterly estimates comparing current market prices for electricity with capped rates paid by consumers. The estimates provide some very general guidance that suggests two important trends: in most cases, current market prices are higher than existing capped rates, and, secondly, market rates can and do fluctuate considerably from day to day, and month to month. These prices listed are not a projection of market prices or the rates consumers will pay when rate caps expire. The Commission's quarterly electric price estimates can be found on the PUC website under the Electricity tab; Electric Price Estimates.

Customers do not necessarily have to pay the utility prices. They may have the ability to choose between an EDC and competitive supply prices for the generation portion of the bill. An EGS may be able to offer a better price for the generation. Customers will be able to compare the EDC price to a competitive supplier price to find the best option. The amount consumers might save depends on issues such as:

- How much they pay now for electric generation supply;
- How much electricity they use;
- How market prices change in the future; and
- The price offered by the suppliers serving in the area.

Generation Price Mitigation Efforts

The Commission continues to engage consumer advocates and industry experts in efforts to mitigate any price increases in future electric generation prices.

The Commission approved rate-mitigation plans such as phase-in or pre-payment plans after directing all utilities to file such programs if electric generation prices increase by more than 25 percent when rate caps expire. PPL, Met-Ed, Penelec and PECO all petitioned the Commission to allow customers to pre-pay in anticipation of price increases for supply service that could occur when generation rate caps expire. All of the programs are voluntary for consumers who can choose to participate. PPL and PECO offer customers 6 percent interest on their bills while Met-Ed and Penelec offer 7.5 percent. The amount plus interest is then paid back to those customers in the form of a credit once rate caps expire.

The Commission also approved a deferral program for PECO's residential and small commercial customers, which will allow qualifying customers to voluntarily opt to receive a credit on their bills in the first year to mitigate the initial financial impact of any rate increase, followed by higher payments in later years to make up the first year credits and accrued interest. PPL has a petition pending before the PUC for a similar deferral program.

In addition, the PUC approved a demand side response rate for eligible PPL customers. The program enables certain customers to lower their electric bill by shifting electricity usage from on-peak periods when wholesale electricity prices and demand are higher to off-peak periods when demand and prices are lower.

Other mitigation efforts include:

- **Energy efficiency and conservation:** Energy efficiency investments often are the most cost-effective means of reducing electricity bills. Examples include: installation of high efficiency lighting, such as compact fluorescent bulbs (CFLs), higher efficiency appliances, repair or replacement of heating or cooling systems, and weatherization of homes and businesses. (*See Act 129 of 2008 Implementation*)

- **Smart Meters:** Reducing usage or shifting load from periods when demand and prices for electricity are high, to periods when demand and prices are low, can have a decisive effect on reducing overall energy costs. (*See Act 129 of 2008 Implementation*)

- **Default Service Supply Procurement:** The Commission has approved energy procurement rules that will reduce default service rate volatility by directing electric utilities to acquire a portfolio of energy products of different contract lengths and at different points in time. This portfolio approach will help insulate customers from large fluctuations in market prices.

- **Updated Low-Income Programs:** Since electricity prices are likely to change with market prices, low-income programs that provide customer assistance and usage reduction must be adjusted accordingly to ensure that low-income customers are able to afford basic utility service.

- **Removal of Barriers to Retail Choice:** The Commission has established a Retail Markets Working Group to examine existing barriers to the development of retail electricity markets in order to recommend policies to the Commission to ensure customers have viable options for their electricity supply when rate caps expire.

- **Consumer Education:** Education is the cornerstone of mitigation strategies. In order to take proactive action on their future energy costs, consumers must be informed of opportunities to reduce usage, have knowledge of pending default service rate increases and utility mitigation programs, have information on shopping for electricity, and know where to go to seek assistance to maintain service. The Commission is actively engaged in the approval, monitoring and implementation of electric utility consumer-education materials (*See Consumers*).

Improving Competition

During the fiscal year, the Commission has taken steps to better monitor the competitive environment for electric generation while at the same time moving forward with measures designed to remove barriers to competition.

On Aug. 7, 2008, the Commission finalized regulations that established reporting requirements to facilitate the measurement of the developing competitive retail electric supply market in the state. The regulations require EDCs and EGSs to report on electric supply activity. The reports will provide specific data that will facilitate Commission efforts to monitor customer switching from the EDC to the EGS for generation supply, as well as customer preference for other products and services such as real-time or time-of-use pricing.

The Commission began on May 14, 2009, to weigh changes designed to remove barriers to a competitive retail electric market. The Commission continues to review comments on the actions necessary to achieve a fully competitive retail market in the PPL service territory – the next territory where rate caps expire. Based on previous experiences with the expiration of rate caps, the PUC believes certain standards, rules and operational protocols will make the retail market more viable for EGSs that wish to offer retail generation services.

On May 30, 2009, new regulations requiring the reporting of retail sales activity information went into effect for all EDCs and active EGSs. Under the new regulations, a distribution company must file quarterly reports, stating retail sales activity information by the customer class as defined in its tariff. An active supplier must file an annual report stating retail sales activity information for customer groups based on annual usage.

The Commission will use the reported sales activity information to monitor the retail electric generation market to prevent market power abuse and discriminatory conduct. The information also will be used to conduct milestone reviews of the development of the retail electric generation market.

Default Service

The 1997 Electricity Generation Choice and Competition Act required electric companies, or a Commission-approved alternative supplier, to provide default electric generation service to customers who have not selected an alternative generation supplier. This is commonly called default service.

The default service regulations provide critical rules and guidance to the industry in regard to the pricing, terms and conditions of service to consumers who decline to choose a competitive supplier, or who are unable to continue service with a competitive supplier.

Act 129 of 2008 amended language concerning default service prices, requiring that the default service prices for electric generation service are required to reflect "the least cost to consumers in the long term." The Commission plans to re-open its default service regulations to ensure they are consistent with the changes in Act 129. Until final regulations are promulgated, the PUC is taking the amended language of Act 129 into its consideration of any EDC default service plans that come before the Commission for approval.

In establishing default service regulations, the Commission also recognized that some elements of default service should be addressed in a policy statement rather than a rulemaking, because changes in markets and technology may result in an approach that is too narrowly tailored or too unresponsive to serve the state's interests.

The policy statement provided procurement guidelines for default service providers to ensure competitive procurement practices; diversify generation supply risks; seek a variety of suppliers and contract terms; and comply with alternative energy requirements. It recommended that default service providers give customers the option to defer paying some portion of a rate increase for a period of time if the retail rate increases by more than 25 percent.

The Retail Markets Working Group also was established in the policy statement to develop policy recommendations that are aimed at removing barriers to retail market development. The working group is addressing specific topics, including information and data access, rate-ready billing, purchase of receivables, customer referral programs, uniform statewide supplier tariffs and a retail choice ombudsman.

Under the mitigation policies, the Commission enhanced its policy of active participation in federal and regional proceedings that impact electricity prices and initiated a rulemaking process to modify its Customer Assistance Programs (CAPs) policy statement and regulations to address funding levels and cost recovery (*See Consumers*).

The Commission's role is to ensure that the process utilities use to establish the default service electricity generation prices achieves the lowest price over the long term. The generation prices are not set by the PUC, but rather are based on the wholesale market, over which the PUC exercises no jurisdiction.

The following actions were taken on default service plans in Fiscal Year 2008-09:

Allegheny Power Co.

A July 25, 2008, Order approved a default service plan for Allegheny Power, which covers default service prices from Jan. 1, 2011, to May 31, 2013, calls for the company to purchase power for residential customers using 12-, 17-

and 29-month contracts, and spot-market purchases to mitigate the impact of price spikes on the competitive markets.

On March 12, 2009, and May 14, 2009, the PUC approved plans for the company to accelerate the purchases of some electricity supply while wholesale energy costs were lower. Moving up the purchases of electric supply for residential customers was designed to allow the company to take advantage of favorable pricing available in the wholesale energy markets at that time.

Citizens' Electric Co. & Wellsboro Electric Co.

Under the companies' default service plans, which cover default service provided from Jan. 1, 2008, to May 31, 2010, a Fixed Generation Supply Service Rate (GSSR) may be adjusted quarterly. The changes to the Fixed GSSR reflect updated estimates to forecast costs and sales, which then are reflected in the rates. The Fixed GSSR is based upon the total amount of annual estimated purchased power costs, plus the total annual estimated administrative charges associated with the purchasing of generation supply to serve the default service customers, divided by the projected total kWh sales for the application period.

The Commission reviews the companies' files to verify computations; ensure the proposed rates reflect the energy contract prices and the Federal Energy Regulatory Commission-approved tariff rates; and determine that the filings are in compliance with company tariffs and Commission orders.

Duquesne Light Co.

Duquesne's current default service plan covers the period from Jan. 1, 2008, through Dec. 31, 2010.

Metropolitan Edison Co. (Met-Ed)

The Commission currently is considering a petition by Met-Ed for a default service program and procurement plan that will establish the default service prices for Jan. 1, 2011, through May 31, 2013.

PECO Energy Co.

The PUC approved a default service plan for PECO on April 16, 2009, that provides for a mix of spot, one-, two- and five-year purchases of energy to establish the default service rates that will be in effect from Jan. 1, 2011, to May 31, 2013.

Pennsylvania Electric Co. (Penelec)

The Commission currently is considering a petition by Penelec for a default service program and procurement plan that will establish the default service prices for Jan. 1, 2011, through May 31, 2013.

Pennsylvania Power Co. (Penn Power)

On Feb. 3, 2009, the Commission determined that the default service prices for Penn Power customers were transparent and non-discriminatory, and reflected market-based prices. This is the company's second default service plan since its rate cap expired Dec. 31, 2006. The plan covers default service provided for commercial customers from June 1, 2009, to May 31, 2010, and residential customers from June 1, 2009, to May 31, 2011.

The Commission verified that the new prices accurately reflect the results of the auction and checked the company's calculations to ensure the new retail electricity prices accurately reflected the electricity costs resulting from the auction. The market-based pricing has triggered electric generation supply marketers to come into the territory and begin to offer alternative products, some of which are about 4 cents/kWh cheaper for residential customers.

Pike County Light & Power (PCL&P)

On Feb. 5, 2009, the Commission approved a settlement for the default service implementation plan for PCL&P. The settlement extended the existing fixed-price aggregation program provided by Direct Energy for an additional two years starting June 1, 2009. It also provides a back-stop, spot-based default service with quarterly price adjustments for those customers who choose that option during this extension period.

PPL Electric Utilities Inc.
On June 18, 2009, the Commission approved a settlement approving a PPL default service program and procurement plan that will establish the default service prices for Jan. 1, 2011, through May 31, 2013.

Under the plan, PPL also will convene a customer collaborative to discuss residential, small commercial and industrial direct mail referral programs. PPL also will convene a collaborative to discuss a retail aggregation program. The results will be considered as part of the company's next default service proceeding.

The plan that established default service prices for 2010 was approved by the PUC on May 10, 2007. Known as the Revised Competitive Bridge Plan, it allowed the company purchased electricity over three years for use in 2010.

UGI Utilities Inc. – Electric Division
On July 17, 2008, the PUC approved a settlement for the default service procurement, implementation and contingency plan for UGI Electric. The company will rely on competitive wholesale market purchases to obtain power for its default service customers in an approach that is designed to provide better protection from congestion risk relative to the base filing. The generation rates resulting from the purchases will take effect Jan. 1, 2010.

Distribution Rate Increase Request

During the fiscal year, the Commission took the following action related to a $1.2 million rate increase request:

Pike County Light & Power Co.
Customers Served: 4,600 in Westfall, Dingman and Milford townships, and Matamoras and Milford boroughs in Pike County
Requested Rate Increase: $1.2 million (9.6 percent)
Approved Rate Increase: $855,000 (6.8 percent)
Primary Reasons: To provide sufficient operating revenues to meet operating expenses, taxes and fixed charges, as well as to provide a reasonable rate of return on the company's investment in electric property

At the end of Fiscal Year 2008-09, there were no rate increase requests pending before the Commission.

Review of Wholesale Energy Market

In late 2008, the PUC held a series of en banc hearings focused on current and future wholesale markets. Because a functional competitive wholesale electric market is important in working toward reasonable prices for consumers, the Commission invited many of the players in the wholesale markets to testify before the Commission on the record because the wholesale market is where electric generation prices are set. The PUC exercises no jurisdiction over the wholesale market. The testimony and other documents related to these hearing are available on the PUC website under the Electricity tab, select Issues then Wholesale Energy Markets.

The PUC intervenes in wholesale market proceedings on behalf of Pennsylvania and in collaboration with other state commissions in proceedings before FERC in order to have an impact on the decisions being made by FERC about wholesale electric markets and interstate transmission of electricity. Among other things, FERC administers the Federal Power Act and is charged by Congress with creating, maintaining and enforcing the essential conditions for a fully competitive, non-discriminatory wholesale electricity market.

Participation in Federal Proceedings

The Public Utility Code authorizes the Commission to appear before federal agencies such as the U.S. Department of Energy (DOE), FERC and the federal courts.

Beyond its responsibility for the wholesale energy markets, FERC also seeks to create proper wholesale market conditions and incentives to ensure the timely construction of necessary generation and transmission facilities to serve anticipated future demand.

A highly competitive and efficient wholesale electric market is integral to the existence of a properly functioning Pennsylvania retail electric market that supplies retail power at reasonable prices for consumers. As FERC delegates operational and market decisions to the Regional Transmission Organizations (RTOs), the PUC participates in many proceedings related to the design and operation of the RTOs in which Pennsylvania is located.

These RTOs are the PJM Interconnection LLC (PJM) and the Midwest Independent Transmission System Operator Inc. (Midwest ISO). The PUC is a member of two organizations of state commissions jointly interested in wholesale market issues – the Organization of PJM States Inc. (OPSI) and the Organization of MISO States Inc. (OMS) – that represent the interests of member states before the FERC.

At present, most of Pennsylvania is within the PJM service territory. The Commission also participates in various FERC proceedings that may be initiated by and against RTOs, generation owners, transmission owners, load-serving entities or end users. In Fiscal Year 2008-09, the Commission increased the involvement of staff in monitoring and advocating Pennsylvania's views on federal and regional energy issues.

Reliability Pricing Model (RPM)

In December 2006, FERC found that PJM's existing generation capacity market was unjust and unreasonable, because it failed to procure sufficient capacity to enable PJM to attract sufficient new generation investment to support a reliable transmission system. To remedy its concern, FERC approved the highly controversial RPM program, a capacity market under which PJM purchases capacity on a multi-year forward basis through an auction mechanism and allocates the costs to wholesale electricity customers.

The cost of capacity is determined by these forward auctions. On Dec. 12, 2008, PJM filed proposed amendments to RPM, and its filing was assigned by FERC to an intensive fast track mediation process in Washington, D.C. The PUC and many other parties intervened and participated in the mediation process.

On Feb. 9, 2009, PJM and most of the PJM wholesale market buyers, municipal and electric cooperatives, the PUC and other state commissions, state consumer advocates, and large end user interests filed a proposed settlement, opposed by most of the generation owners in PJM. On March 26, 2009, FERC issued its Order on the proposed settlement which took the proposed settlement as a starting point for disposition, while giving consideration to many of the objections of the PJM generators in modifying the terms of the settlement, and directing that certain issues be returned to PJM's stakeholders for further development.

Although the changes to RPM and recent economic events have resulted in a sharp decrease in capacity prices in many PJM subregions, RPM and its ongoing effect on wholesale markets and generation investment continue to be of regional concern. The PUC is actively participating in the ongoing RPM stakeholder process. Additional PJM-proposed modifications to RPM filings are expected to be filed at FERC later in 2009 and 2010.

FERC Order 719

FERC issued final rules directing all jurisdictional RTOs to convene stakeholder committees to discuss and for the RTOs to subsequently propose specific tariff changes regarding wholesale market demand response, "scarcity" pricing rules, long-term power contracting, RTO responsiveness and organization, market structure, and market monitoring. The PUC actively participated in the Order 719 stakeholder discussions. While the outcome of some of the stakeholder committee deliberations was favorable to Pennsylvania, PJM's April 29, 2009, filing presented some major problems for Pennsylvania retail customers, resulting in protests by the PUC and the Organization of PJM States. The protests primarily dealt with PJM's proposed changes to the structure and functions of its external independent market monitor (IMM)– asserted to be in violation of a 2007 settlement of several complaints by the PUC and others against PJM management. The complaint alleged that PJM was intruding on the independence of the PJM market monitoring unit (MMU) by attempting to exercise management control over MMU findings, reports and operations. The 2007 settlement recast the MMU as the IMM. The settlement was alleged to have been violated by PJM's request for tariff approval to reassert control over MMU functions. FERC will likely issue an Order in Fiscal Year 2009-10, accepting, rejecting or ordering a modification of the PJM compliance filing.

Other FERC proceedings include:

- PJM Market Monitoring Issues
- PJM Economic Demand Response Filing
- PJM Scarcity Pricing Issues
- PJM Cost of New Entry (CONE) Determination
- PJM Complaint against PowerEdge
- MISO Resource Adequacy

Transmission Planning

Many of the transmission planning issues are on hold because interested parties, including the PUC, are waiting to see if Congress opts to act on any of the number of proposals before them that could federalize both the siting and planning for transmission lines. As in the past, the PUC will continue to actively participate in this process to protect Pennsylvania interests.

Calling the plan overly broad and unreasonable, on Nov. 5, 2007, the PUC filed for rehearing with DOE over its National Interest Electric Transmission Corridor (NIETC) for the Mid-Atlantic Region while also filing suit against the designation in U.S. District Court for the Middle District of Pennsylvania. In its filing in the U.S. District Court, the Commission maintained that the NIETC is beyond the scope intended by Congress in the Energy Policy Act of 2005. The Middle District case is on hold pending the resolution of the 9th Circuit appeal. The PUC is awaiting an argument date for that appeal. Section 1221 of the Energy Policy Act of 2005 directed DOE to conduct studies of electric transmission congestion every three years, and authorized the federal agency to designate NIETCs based on those studies. DOE is conducting its 2009 National Transmission Congestion Study in order to issue an updated NIETC in the first quarter of Fiscal Year 2009-10. The PUC will continue to monitor this process to ensure the rights of Pennsylvania are protected.

Also, Eastern states such as Pennsylvania are involved in an interconnection initiative which, if successful, would result in a coordinated transmission siting plan for the Eastern United States. If that process continues to move forward, the NIETC process may be rendered moot.

Alternative Energy Portfolio Standards Act of 2004

Signed into law on Nov. 30, 2004, the Alternative Energy Portfolio Standards Act (AEPS) requires EDCs and EGSs to include a specific percentage of electricity from alternative resources in the generation they sell to Pennsylvania customers. Since the passage of AEPS, the PUC has moved expeditiously to develop the rules and regulations necessary for fostering Pennsylvania's alternative energy market. Each year, the Commission continues to address the issues that arise as more EDCs, EGSs and alternative energy systems attempt to follow the mandates of the Act.

On Sept. 25, 2008, the PUC finalized the regulations that govern compliance with AEPS by the EDCS and EGSs. The regulations reflect the Commission's understanding that the Act is intended to promote the efficient utilization of the region's alternative energy resources, in a manner which will yield significant economic and environmental benefits in Pennsylvania. Act 129 of 2008 expanded the definition of alternative energy sources that qualify as Tier I resources under AEPS. On May 28, 2009, the PUC finalized procedures and guidelines that allow for the limited expansion of alternative energy sources that qualify in Tier I under AEPS to include Pennsylvania-based low-impact hydropower facilities and generators utilizing by-products of pulping and wood manufacturing processes. The PUC also created reporting requirements and related procedures that the PUC will use to adjust the AEPS Tier I requirements to account for the newly qualified resources.

In Fiscal Year 2008-09, the Commission established the standard application forms and fees for customer-generators wanting to interconnect to the electric grid. A major component of AEPS includes directions for how customer-generators, who use technologies such as solar panels, fuel cells or biodigesters, can connect to the electric distribution system. The PUC had previously established the rules for those interconnections and how the customer-generators will be compensated by EDCs and

EGSs for providing surplus energy to the electric grid. The forms are available on the PUC website under the Electricity tab, select Alternative Energy.

As the Act evolves and matures, the Commission will tackle the issues in a way that will facilitate implementation of this important component of the Commonwealth's overall energy policy. In its most recent performance audit of the PUC, the Legislative Budget & Finance Committee (LB&FC) said the Commission "made good progress" in implementing the requirements of the Act.

Reliability

Under the Customer Choice Act, each EDC is obligated to ensure that its service does not deteriorate below the level of service reliability that existed prior to the Jan. 1, 1997, effective date of the Act.

The monitoring efforts by the Commission are focused on reviewing annual and quarterly reports filed by the electric distribution companies. Large electric companies have to stay within 10 percent of a PUC-established benchmark for a rolling three-year period and within 20 percent of the benchmark during a rolling 12-month period. Four smaller electric companies – UGI Electric Co., Citizens' Electric Co., Pike County Light & Power and Wellsboro Electric Co. – also must stay within 10 percent of their benchmark for a rolling three-year period, but will be allowed to go up to 35 percent of the benchmark for the rolling 12-month period. Benchmarks are the Commission's goals for each utility on the number and duration of outages.

The Commission issued the annual reliability report – Electric Service Reliability in Pennsylvania – in July 2009. The report trends reliability performance from 1994 to the first quarter of 2008, and includes the causes of outages, by percentage, and information on all major events. It can be viewed at the Commission's website at www.puc.state.pa.us under Publications and Reports.

Electric Power Outlook

Each public utility that produces, generates, distributes or furnishes electricity must annually submit to the Commission information concerning its future plans to meet its customers' demands. The Commission is required to submit the report to the General Assembly, the Governor, the state's Office of Consumer Advocate and each affected public utility each year.

This year's report concludes that sufficient generation, transmission and distribution capacity exists to reasonably meet the needs of Pennsylvania consumers for the near future. However, there are generation adequacy concerns beginning in 2013.

Regional generation adequacy and reserve margins of the Mid-Atlantic area have been maintained. While sufficient generation capacity is expected until at least 2013, the Commission will continue its current policy of encouraging generation adequacy within the

Tom Daise of PPL discusses transmission technology to PUC staff in PPL's Transmission Control Center.

region. With respect to transmission adequacy, the transmission system in the Mid-Atlantic Region has sufficient capacity to meet demand. Transmission expansions and upgrades are being planned for the next five years to reinforce the bulk of the power grid.

Inspection and Maintenance Standards

On May 22, 2008, the Commission finalized its regulation for inspection, maintenance, repair and replacement standards for EDCs. The regulation requires an EDC to have a plan for: periodic inspection and maintenance of poles, overhead conductors and cables, wires, transformers, switching devices, protective devices, regulators, capacitors, substations, and other facilities critical to maintaining an acceptable level of reliability. The regulation also sets forth minimum inspection and maintenance intervals for vegetation management, poles, overhead lines and substations.

On July 17, 2008, the PUC issued an Advanced Notice of Proposed Rulemaking to consider establishing inspection, maintenance, repair and replacement standards regarding neutral connections under Chapter 57 of the Pennsylvania Code. The Advanced Notice solicits comments from the EDCs and other parties of interest. The comments are under review in preparation for final rulemaking proceedings.

Outage Response

After hurricane-force winds knocked out power to more than 450,000 Western Pennsylvania residents, the PUC launched a statewide evaluation of storm responses by all of its EDCs. On Sept. 25, 2008, the Commission initiated a statewide evaluation of EDC storm response tactics, including their power restoration practices and customer communications.

The evaluation resulted in recommendations designed to lead to improvements in the response of EDCs to large-scale service outages. The PUC then began the process of changing the regulations governing service outages and reportable incidents. The Commission also will open proceedings to develop a policy statement that provides guidelines for how the EDCs should communicate with the public during outages.

The Commission expects to issue a proposed rulemaking and policy statement in Fiscal Year 2009-10.

Mergers and Acquisitions

In reviewing mergers and acquisitions, the Commission works to make certain that customers are protected and the company is a viable public utility and a good neighbor. The PUC gives each application a thorough and comprehensive review. In Pennsylvania, the legal standard asks whether an affirmative public benefit will result from the merger or acquisition. Public benefit is defined typically as protecting the public interest, encouraging economic development and safeguarding the environment.

The PUC did not consider any mergers or acquisitions of electric companies this year.

Transmission Line Proceedings

The state's Public Utility Code requires its public utilities to furnish and maintain adequate, efficient, safe, and reasonably priced utility service and facilities. It also allows utilities to make the changes necessary to ensure the quality and safety of that service. The PUC is the agency charged with ensuring that the public utilities are living up to those obligations. That includes oversight of the siting and construction of electric transmission lines. As discussed earlier in this chapter, the PUC has been active in preserving state jurisdiction over transmission line siting, taking an active role in the DOE's NIETC designation.

Transmission line siting cases present two distinct issues: whether the need for the line exists; and whether the proposed route is the best of all alternatives considered. When an application of this nature is received, the Commission is required to hold hearings to consider the necessity, safety and environmental impact of the proposed line. The Commission also considers a variety of other issues, including risk of danger to the health and safety of the public, compliance with applicable statutes, and regulations providing for the protection of natural resources and minimal adverse environmental impact. Additional information on the PUC process for transmission line siting is available on the PUC website under Consumer Education.

Some large transmission line proceedings are being considered throughout the state, including:

Trans-Allegheny Interstate Line Co. (TrAILCo)

On Nov. 13, 2008, the Commission approved an agreement that allowed a 1.2 mile portion of the 37.2-mile transmission line proposed by TrAILCo and stayed the remainder of the proceeding for further consideration.

TrAILCo filed an application seeking Commission approval to locate, construct and operate a proposed transmission-line project in portions of Washington and Greene counties. More than 300 protests and interventions were filed on behalf of various parties. In order to provide adequate opportunities for community input, the Administrative Law Judges (ALJs) assigned to the case held 12 public input hearings in various locations of Washington and Greene counties in fall 2007. Evidentiary hearings were conducted in spring 2008, in which the legal, policy and evidentiary issues were addressed.

PPL Coopersburg Transmission Line

On Feb. 14, 2008, PPL filed an application for approval to site, construct and operate the proposed transmission line in Upper Saucon Township, Lehigh County, and Springfield and Richland townships in Bucks County. Known as the Coopersburg Project, public input and evidentiary hearings were held in Fiscal Year 2008-09, followed by a recommended decision from the presiding ALJ. A final decision is expected in Fiscal Year 2009-10.

PPL Susquehanna-Roseland Transmission Line

PPL filed an application on Jan. 6, 2009, to construct a new 500 kV transmission line. Known as the Susquehanna-Roseland project, the proposed line is about 101 miles long and travels through portions of Lackawanna, Luzerne, Monroe, Pike and Wayne counties. PPL also requested authorization to construct a new substation in Blakely Borough, Lackawanna County, to connect the 500 kV line to the regional transmission system in that area.

Four public input hearings have been held on the project with evidentiary hearings scheduled for the second quarter of Fiscal Year 2009-10. A recommended decision from the presiding officer, as well as a final decision by the Commission, will follow later in Fiscal Year 2009-10.

Renewable and Sustainable Energy

The PUC monitors periodic board meetings held by the five sustainable energy funds. The PUC also chairs the Pennsylvania Sustainable Energy Board, which provides suggested operational and best practices for the regional funds as well as promotes the transparency of the funds' activites and projects.

Various restructuring and merger settlements from electric competition allocated nearly $80 million of ratepayer funds, over about a 10-year period beginning in 1998, for regional projects to develop renewable and clean energy technologies. The Commission is responsible for approving nominations to each fund's board of directors and changes to their governing bylaws. Examples of projects for which the regional boards have approved funding include wind farms, photovoltaic applications, efficiency loan programs and renewable energy education.

In 2007, the funds provided slightly more than $6.5 million in loans and about $1.9 million in grants for investments in renewable and clean energy, and energy efficiency projects. Commission staff continues its liaison role with the regional sustainable energy funds.

Electric Company Audits

The Commission's Bureau of Audits periodically performs management and operations audits (MAs) or management efficiency investigations (MEIs) of the jurisdictional electric distribution companies.

In addition to the periodic MAs and MEIs, the PUC annually conducts a variety of other EDC audits. During the fiscal year, 15 audits involving competitive/intangible transition charges, purchased power, non-utility generation, transmission service costs, consumer-education programs and universal service programs were completed. Also, 63 filings requesting changes to established adjustment clause rates were reviewed and processed, implementing revised surcharge rates.

Among the MAs and MEIs completed within the 2008-09 fiscal year were:

UGI Utilities Inc. and
UGI Penn Natural Gas Inc.

The MEI released Oct. 9, 2008, showed that UGI and UGI Penn could realize combined yearly savings up to $36,000 and one-time savings of up to $240,000 by implementing the recommendations contained in the report.

The MEI examined UGI's progress in implementing 20 of the 23 original recommendations from a February 2005 MA, the companies' compliance with the order approving the acquisition of PG Energy, and its emergency preparedness.

The auditors found that UGI effectively implemented 10 of the 20 prior recommendations reviewed and has taken some action on the 10 remaining recommendations resulting in realized annual savings of approximately $489,000 and one-time savings of $48,000.

Changes implemented by the companies included: initiating efforts to fully deploy automated meter reading devices to both gas and electric customers; revitalization of the theft of service program; reducing call center staffing; and eliminating excess substation inventory.

Additionally, the audit report contained 15 follow-up recommendations for improvement, including efforts to: initiate steps to remove long-term individual customers from its gas beyond the main program; replace defective cutouts to reduce electric outages due to equipment failure; fully comply with recently established four- to eight-year tree trimming cycles; strive to improve safety performance and consistently meet Electric Division safety goals; annually review and update certain emergency response and physical security plans as appropriate; and initiate actions to improve UGI Penn quality of service performance and achieve the benchmark levels not currently being met, regularly monitor ongoing service quality, and as necessary take action to correct any deficiencies that occur. The Commission directed the companies to proceed with their plans to implement the follow-up recommendations.

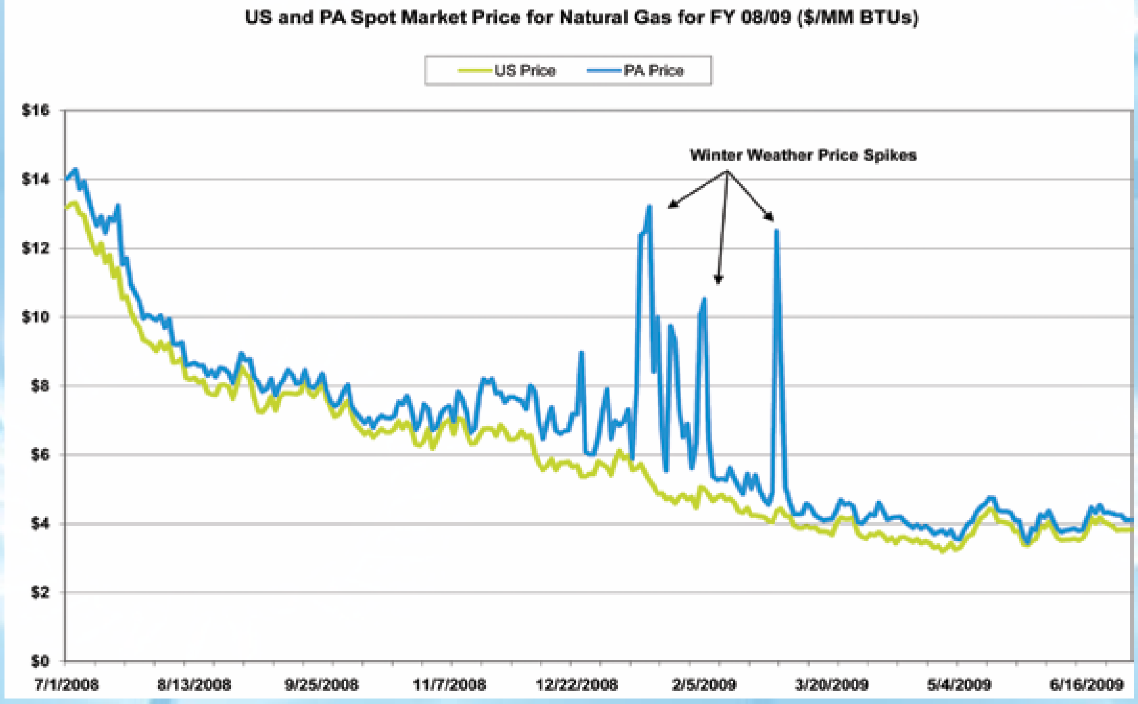
NATURAL GAS

Working to ensure safety, the PUC inspects the state's natural gas pipelines while regulating natural gas distribution company base rates and default service rates, and encouraging the development of competitive markets.

Fiscal Year 2008-09 was notable for the lack of volatility in the natural gas markets, which in turn meant that the price of gas stabilized and actually dropped significantly. The Commission initiated stakeholder action items that are designed to remove market barriers and increase competition in Pennsylvania's retail natural gas services market. The PUC also expressed its support to the legislature for a distribution system improvement charge which would facilitate the timely recovery of costs of infrastructure improvements and would promote increased safety in the state's natural gas distribution system. The PUC's Gas Safety Division continues to monitor the safety of the fuel that heats 51 percent of the homes in the state. Settlements for about $160,000 were reached with a natural gas company that was under informal investigation for violating portions of the Public Utility Code or PUC regulations. Currently, Pennsylvania has 34 regulated natural gas distribution companies and 81 licensed natural gas suppliers.

Wholesale Natural Gas Prices

For Fiscal Year 2008-09, natural gas prices were little affected by either Hurricane Gustav or Hurricane Ike. In fact, as shown in the accompanying chart, natural gas prices decreased throughout the entire year. Prices dropped from a high in Pennsylvania (blue line) of just over $14/MM BTUs (one million British thermal units) in early July 2008 to a low of about $4/MM BTUs in late June 2009.



Much of the price decrease can be attributed to the decline in demand associated with the recession and increased natural gas production of about 9 percent in 2008.

Pipeline expansion continues. According to the U.S. Energy Information Agency (EIA), during 2008, at least 84 natural gas pipeline projects were completed in the lower-48 states, adding close to 4,000 miles of natural gas pipeline and about 43.9 billion cubic feet (Bcf) per day of new capacity to the national natural gas pipeline grid. This will prove beneficial during the anticipated economic recovery.

Looking forward, the EIA sees the monthly average Henry Hub natural gas spot price remaining below $4 per thousand cubic feet (Mcf) until late in the year given plentiful U.S. natural gas supplies and weak demand, particularly in the industrial sector. The Henry Hub price is projected to increase from an average of $4.22 per Mcf in 2009 to an average of $5.93 per Mcf in 2010 as expected economic growth increases industrial consumption of natural gas.

SEARCH

On Sept. 11, 2008, the Commission adopted an action plan that grew out of the efforts of the Stakeholders Exploring Avenues for Removing Competition Hurdles (SEARCH). SEARCH is a working group comprised of stakeholders representing residential, commercial and industrial customers, natural gas distribution companies, suppliers, and pipelines.

The action plan was designed to increase effective competition in the retail market for natural gas supply. Since September, the Commission has initiated rulemakings and issued interim guidelines, all of which are intended to reduce market barriers to competition identified during the SEARCH proceedings.

The action plan is being implemented in two phases and includes the adoption of the following three proposed rulemakings:

- Market Issues: Issues addressed will include price to compare; purchase of receivables and mandatory capacity assignment; and recovery of reasonable competition-related costs.
- Supplier Issues: Issues addressed will include standard language for financial instruments; and reasonable criteria for security requirements.
- Distribution Company Business Practices: Issues addressed will include supplier tariffs; standardized business practices (imbalance trading, tolerance bands, cash out and penalties, nominations, and capacity); and communication standards and formats.

The action plan is expected to be completed within two years.

Also, earlier this year, the Commission implemented another SEARCH recommendation by establishing the Office of Competitive Market Oversight (OCMO). This office is within the Director of Operations' Office and is staffed as necessary by technical and legal staff from other Commission bureaus. The OCMO's purpose is to assist with informal dispute resolution between natural gas distriubtion companies (NGDCs) and natural gas suppliers (NGSs) on requirements to help facilitate the NGSs' entry and participation in the retail market.

The 1999 Natural Gas Choice and Competition Act allowed customers to purchase gas from independent suppliers, while still having their gas physically delivered by PUC-regulated distribution companies. In October 2005, a Commission report found that effective competition did not exist in the natural gas markets. SEARCH was formed and tasked with developing recommendations for legislative, regulation or policy changes that would increase competition in the retail natural gas market.

Small Natural Gas Company Task Force

On Jan. 15, 2009, the Commission formed a task force to review the operations of small natural gas utilities. Small natural gas utilities are defined as having intrastate operating revenues under $40 million. The PUC has 21 small natural gas companies under its jurisdiction.

The purpose of conducting a full-scale review of the small natural gas utilities is to ensure that customers of all natural gas companies are receiving safe and adequate service.

On June 17, 2009, PUC staff met with representatives from various small natural gas utilities to discuss a range of issues. Among those items discussed were:

- The array of reports the companies are required to file;
- Gas safety issues;
- An overview of the ratemaking process;
- Procedures for terminations and abandonments of service;
- The need to maintain accurate records for plant investments and expenses;
- The company's ability to maintain sufficient operating funds and earn a fair return by filing a base rate case and keeping current with gas cost rate adjustments; and
- Suggestions for customer notifications.

Natural Gas Distribution System Improvement Charge

Based on experience in the water industry, the PUC urges the creation of a distribution system improvement charge (DSIC) to allow natural gas companies to use a surcharge on customers' bills to accelerate the replacement of infrastructure improvements. Otherwise, the utility must wait until the completion of a rate case to begin recovering its investment and receiving a return on its investment.

Legislation that would give the PUC authorization to institute a system improvement change for natural gas utilties is pending in the General Assembly as House Bill 744.

System improvement charges reduce the frequency and the associated costs of base rate cases while maintaining a high level of customer protections. The DSIC is designed to provide ratepayers with improved service quality; greater rate stability; fewer main breaks; fewer service interruptions; increased safety; and lower levels of

unaccounted for natural gas/wastewater. In light of today's difficult financial markets, DSICs and a Collection System Improvement Charge (See *Water/Wastewater*) are the type of innovative regulatory policies expected as rating agencies tighten ratings benchmarks and are a key element in maintaining access to capital markets on reasonable terms.

Section 1307 of the Public Utility Code authorizes the PUC to prescribe a mandatory system for automatic adjustment of a utility's rates by means of a sliding scale of rates. In 1997, the Public Utility Code was amended to add Section 1307(g), which specifically provided for an adjustment clause for the recovery of costs related to distribution system improvement projects designed to enhance water quality, fire protection reliability and long-term system viability.

The PUC has expressed support for a gas DSIC for NGDCs and testified before the House Consumer Affairs Committee. The PUC would like the legislation to authorize the Commission to establish reasonable parameters for use of the DSIC, via regulations, as is presently the case for water utilities. The PUC has indicated that it also should have oversight of the securitization process, which would only be available to PGW. The bill also brings treatment of natural gas service lines in line with industry practice relative to electric service lines, both of which present inherent risks to activity on and near such lines. The NGDC would be responsible for service lines and safety issues related to service line leaks, excavations and siting. The PUC also supports this aspect of the proposed legislation.

Base Rate Increase Requests

During the fiscal year, the Commission took the following actions related to about $270 million in rate increase requests:

PECO Gas

Customers Served: 482,000 in parts of Bucks, Chester, Delaware and Montgomery counties

Requested Rate Increase: $98.3 million (11.2 percent)

Approved Rate Increase: $76.5 million (8.7 percent)

Primary Reasons: To invest in the natural gas infrastructure to ensure safe and reliable service

Philadelphia Gas Works (PGW)

Customers Served: 510,000 within the city of Philadelphia

Requested Rate Increase: $60 million (5.2 percent)

Approved Rate Increase: $60 million (5.2 percent)

Primary Reasons: To provide emergency rate relief to cover cost of interest. As part of the approval of the emergency rate relief, PGW was ordered to apply for a fully litigated base rate case by Dec. 31, 2010.

Columbia Gas of Pennsylvania Inc.

Customers Served: 412,000 within Adams, Allegheny, Armstrong, Beaver, Bedford, Butler, Centre, Clarion, Crawford, Elk, Fayette, Franklin, Fulton, Greene, Indiana, Jefferson, Lawrence, McKean, Mercer, Somerset, Venango, Warren, Washington and Westmoreland counties

Requested Rate Increase: $58.9 million (9.1 percent)

Approved Rate Increase: $41.5 million (6.4 percent)

Primary Reasons: To continue implementing an ongoing program that began last year to replace approximately 600,000 feet of aging underground pipes and distribution facilities each year, and to use state-of-the-art technologies during the upgrades

Equitable Gas Co.

Customers Served: 226,000 in the City of Pittsburgh, and various boroughs and townships in Allegheny, Armstrong, Butler, Clarion, Fayette, Greene, Indiana, Jefferson, Washington and Westmoreland counties

Requested Rate Increase: $51.95 million (10 percent)

Approved Rate Increase: $38.35 million (7.4 percent)

Primary Reasons: To cover rising operating and maintenance expenses, as well as to recover costs of investments in the utility's plant and investments to improve the quality of service for its customers

Northeast Heat & Light Co.

Customers Served: 2,900 in North East, Erie County

Requested Rate Increase: $500,318 (11.2 percent)

Approved Rate Increase: $369,698 (8.2 percent)

Primary Reasons: To fund increases in material, labor and other costs

Sergeant Gas

Customers served: 113 in Wetmore Township, McKean County, and Jones Township, Elk County

Requested Rate Increase: $48,349 (29.2 percent)

Approved Rate Increase: $26,870 (16.2 percent)

Primary Reasons: To fund increases in operating expenses and other costs

At the end of Fiscal Year 2008-09, two natural gas rate increase requests were pending before the Commission: UGI Central Penn Gas ($19.6 million) and UGI Penn Natural Gas ($38.1 million).

PGW Appeal of 2007 Rate Decision

The Commission's Sept. 13, 2007, Order approving a $25 million base rate increase for PGW has been affirmed by the Commonwealth Court of Pennsylvania, and pleadings are currently pending in the Supreme Court of Pennsylvania, which will decide whether to review the Commonwealth Court's decision on appeal. The PUC and the Office of Consumer Advocate have filed answers opposing PGW's request for the Supreme Court to review the Commonwealth Court's decision.
PGW filed for PUC approval of a $107 million (11 percent) increase in base rates on Dec. 22, 2006. After suspending the proposed increase for hearing and investigation, the PUC approved a $25 million increase. In its appeal to Commonwealth Court, PGW argued that a five-year future period should be the basis for determining an appropriate level of rate relief and challenged the PUC's use of a traditional test-year concept, adjusted to reflect known and measurable changes. PGW also argued that the PUC had incorrectly calculated its allowance for bad debt expenses.

Affirming the PUC's decision, the Commonwealth Court found that the Commission had applied the proper ratemaking methodology and requirements as set forth in Chapters 13 and 22 of the Public Utility Code, as well as the City of Philadelphia's Management Agreement Ordinance. The Commonwealth Court also agreed with the PUC's manner of calculating PGW's allowance for bad debt expense. The parties are awaiting a decision from the Supreme Court as to whether PGW's appeal will be heard.

PGW Working Group, Collaborative with Competitive Suppliers

On Dec. 18, 2008, in the context of approving emergency rate relief in the amount of $60 million, the Commission established a working group to examine PGW's financial situation. The group was directed to recommend improvements, solutions and other courses of action that can be implemented to maintain the company's financial viability. The Commission recognized that PGW's current management team has taken a number of steps to move PGW in a positive direction, but stated that other significant initiatives may be necessary to ensure that the company is able to provide safe, reliable and reasonably priced service to its customers.

The Working Group – comprised of representatives of the Commission, PGW and the City of Philadelphia Mayor's Office – has focused on PGW's overall cash flow position and the status of the rollover of two tranches of commercial paper (together totaling $148 million) during the first quarter of 2009. The group also has discussed PGW's remarketing efforts in connection with the 2006 bonds.

The Commission also ordered PGW to begin a collaborative process in February 2009 to explore options for transitioning some or all of its customers to an alternative default supplier. This proposal was raised by natural gas suppliers that participated in the company's emergency rate relief proceeding and was based on evidence that PGW purchases natural gas for its customers in the amount of $600 million to $700 million annually from borrowed funds.

As required, PGW submitted a report to the PUC in April, detailing the progress made and identifying the areas of agreement among stakeholders; stakeholders are permitted to submit alternative reports recommending a course of action. This process is to continue until the stakeholders agree to submit a final action report, unless the Commission orders otherwise.

Mergers and Acquisitions

In reviewing mergers and acquisitions, the Commission works to make certain that customers are protected and the company is a viable public utility and a good neighbor. The PUC gives each application a thorough and comprehensive review. In Pennsylvania, the legal standard asks whether an affirmative public benefit will result from the merger or acquisition. Public benefit is defined typically as protecting the public interest, encouraging economic development and safeguarding the environment.

The following proceeding was before the Commission in the natural gas industry:

UGI Utilities Inc./PPL Gas Utilities Corp.
On Aug. 21, 2008, the PUC approved a settlement for the purchase of PPL Gas by UGI, finding that the partial settlement reached in the case was in the public interest by affirmatively promoting the service, accommodation, convenience or safety of the public in some substantial way. Under the settlement, the company, among other things, would not request a base rate increase for one year while maintaining the current PPL Gas purchased gas cost rates, would expand PPL Gas funding for its Low Income Usage Reduction Program, and would provide annual reports for five years regarding the quality of consumer service. UGI serves 307,000 natural gas customers in 14 Pennsylvania counties. PPL Gas serves about 75,000 customers in 27 counties in Pennsylvania. At the end of Fiscal Year 2008-09, the

Commission also was considering a petition by Exelon, the parent company of PECO, to acquire NRG Energy, as well as a proposal by SteelRiver Infrastructure Partners, formerly Babcock & Brown Infrastructure Fund North America, to purchase Dominion Peoples Natural Gas Co.

Gas Safety Issues

The PUC is responsible for enforcing the Commission's pipeline safety regulations as they apply to natural gas and other public utilities transporting certain commodities by pipeline within Pennsylvania. Generally, the PUC ensures that pipeline utilities comply with the federal pipeline safety regulations that have been adopted by the PUC as its safety standards. The PUC monitors compliance with these regulations by conducting frequent inspections of pipeline facilities and examining safety records of regulated gas utilities. The inspectors also investigate incidents that include fires, explosions and major outages.

Natural Gas Pipeline Reportable Incidents

In 2008, the Commission investigated four reportable incidents. During the previous three years, natural gas utilities reported 22 incidents, including eight in 2005, eight in 2006 and six in 2007.

A reportable incident may involve an explosion, a release of gas, and, unfortunately, sometimes personal injury or loss of life. The PUC's regulations require a utility to submit a report of an accident involving facilities or operations that meet one or more of the following circumstances: 1) a release of gas involving death or injury; 2) a release of gas and $50,000 in property damages, including lost gas; and 3) a release of gas that results in an event considered significant by the operator. During the past five years, the most frequent causes of reportable incidents were facility damage, operator error and corrosion. A public utility also must immediately notify the federal government through the National Response Center of all reportable incidents.

The cause of pipeline incidents has varied during the past several years, but the PUC has identified the most frequent causes as excavation damage; natural causes such as flooding; automobile accidents; pipeline leaks caused by corrosion; and human error. In 2008, the incidents were caused by operator error, corrosion and excavation damage.

The division has utilized information gathered from its incident investigations to ensure its inspection efforts focus particular attention on the areas that have previously resulted in reportable incidents.

Natural Gas Safety Investigation Settlements

In Fiscal Year 2008-09, the PUC approved two settlements with UGI that totaled more than $160,000.

On Feb. 5, 2009, the Commission approved a settlement with UGI that included a $5,000 civil penalty and $115,000 in improvements to safety efforts at the company after a natural gas explosion in Lancaster. The settlement followed a formal investigation by the PUC's independent Prosecutory Staff into a March 26, 2004, gas explosion on the 400 block of Queen Street, Lancaster, that injured a UGI employee who was investigating the basement of a residence at the time. Although the gas explosion did not cause a fire, portions of the basement were scorched, and the UGI employee suffered burns to his hands and face.

On Oct. 23, 2008, the Commission finalized a settlement with UGI that included a $40,000 contribution to the company's Operation Share hardship fund, which helps low-income consumers maintain service. The settlement also included provisions to increase gas safety and leak detection.

The settlement followed an informal investigation of a Sept. 2, 2006, gas explosion at 39 Apple Blossom Drive, West Lampeter Township, Lancaster County. In both cases, the civil penalties cannot be recovered from ratepayers.

Additional Gas Safety Activities Include:

- 914 inspections (compliance, regulator and relief station, discontinued service, corrosion control, transmission line, and compressor station inspections);
- Four investigations of reportable incidents;
- 30 non-compliance letters issued;
- 82 gas safety violations issued;
- 74 violations handled by non-compliance letters; and
- 8 violations pursued by enforcement staff

Gas Company Audits

During the fiscal year the Bureau of Audits completed seven purchased gas cost audits, 10 gas cost rate audits, one consumer-education audit, one universal service program audit and three special audits/reviews. The Bureau also reviewed 15 gas cost rate (GCR) adjustment clause filings implementing revised GCR rates. In addition, the Bureau performs periodic management and operations audits (MAs) and management efficiency investigations (MEIs) of natural gas companies. Among those MAs and MEIs completed during the 2008-09 fiscal year were:

UGI Utilities Inc. (Gas Division) and UGI Penn Natural Gas Inc. *(See Electric)*

PGW

A Stratified Management and Operations Audit report by Schumaker & Company released on Feb. 5, 2009, showed PGW could experience yearly savings of up to $7.35 million and one-time savings of up to $2 million by implementing recommendations contained in the audit report. Also, the report indicated that PGW has taken positive steps toward improving deficiencies found during a 2001 audit, including slowly improving customer collection issues and the efficiency and effectiveness of its operations despite its financial constraints.

The bulk of the audit fieldwork was completed in 2007 with limited amounts of fieldwork conducted during the first half of 2008. The report, therefore, does not reflect the impact of the economic downturn of 2008 on PGW. The audit analyzed and evaluated management performance in 14 functional areas and resulted in 93 recommendations for improvement.

In its implementation plan, submitted to the Commission on Jan. 22, 2009, PGW accepted 88 recommendations, partially accepted three recommendations and rejected two recommendations.

The recommendations accepted or partially accepted by the company include: undertake a major study to improve its gas theft prevention program; re-evaluate the use of the soft-off program, whereby technicians are not dispatched to shut off the gas to the premises of customers who discontinue service, but instead the gas usage is monitored; change the focus of the procurement department; initiate increased efforts to reduce the level of inventory maintained in the storerooms and number of employees in the Materials Management Department; assess the root causes of absenteeism and quality of work issues in the call center; implement management incentive compensation; and strengthen the board's audit committee function. PGW rejected recommendations related to streamlining the company's corporate governance process and working to develop a plan for addressing the high cost of Universal Service programs on ratepayers. PGW claimed that implementation of these recommendations are beyond its control.

The Commission will conduct a follow-up on the company's implementation efforts during a future Management Efficiency Investigation.

T.W. Phillips Gas & Oil Co.

The MA report released April 16, 2009, shows that T.W. Phillips could experience yearly savings up to $1.1 million and one-time savings of up to $266,000 by effectively implementing the 28 recommendations contained in the report. The MA analyzed and evaluated management performance in various functional areas. In its implementation plan submitted to the Commission on March 20, 2009, T.W. Phillips accepted 15 recommendations, and partially accepted the other 13 recommendations. Some of the areas recommended for further improvement include: establish a debt reduction/financial management plan to reduce total debt and control the level of its short-term debt; modify, track and enforce the damage prevention program; bill for all non-company caused hits and initiate solutions to reduce the number of company-at-fault hits; initiate actions to increase collection agency recovery rates; re-evaluate economic order quantities and economic order points with a goal of reducing inventory levels and improving turnover; apply an overhead rate to all salary and labor charges for recovery of the cost of employee benefits from Energy Corp. and Supply Corp., and annually recalculate and modify the rate; and file an affiliated interest agreement with the Commission for approval of goods and services provided by T.W. Phillips to Supply Corp.

The company reported that as of March 2009 it had already implemented five of the recommendations, 12 of the implementation efforts are ongoing, nine are scheduled for implementation by Dec. 31, 2010, and the remaining two recommendations are subject to the Collective Bargaining Agreement, which does not expire until Dec. 31, 2011. The Commission will conduct a follow-up on the company's implementation efforts during a future Management Efficiency Investigation.

Steam Heat

Three steam heat utilities currently operate in Pennsylvania. Generally, steam heat is produced in central generation plants by heating water to its boiling point, and then distributing the steam heat to users through a series of underground pipes. In Fiscal Year 2008-09, the PUC's Bureau of Audits reviewed 34 (monthly and annual) steam cost rate adjustment clause filings submitted by jurisdictional steam heat companies.
In addition, two steam cost rate audits were completed.

Base Rate Increase Requests

During the fiscal year, the Commission took the following action related to a $1.8 million in rate increase request:

NRG Energy Center Harrisburg LLC
Customers Served: 232 in Harrisburg, Dauphin County

Requested Rate Increase: $1.8 million (42 percent)

Approved Rate Increase: $1.1 million (28 percent)

Primary Reasons: To enable the company to cover its operating expenses and provide a revenue stream that will allow NRG Harrisburg to fund new investment that enhances system reliability and efficiency.

TELECOMMUNICATIONS

In promoting a competitive telephone market, the PUC works to ensure reasonable local rates, accelerate the deployment of high-speed Internet service, and make programs available so that no consumer is left without local telephone service.

During this fiscal year, the Commission began exercising its jurisdiction to determine whether a wireless carrier qualifies for federal support as an eligible telecommunications carrier (ETC) in Pennsylvania. The Commission also continues to monitor the aggressive broadband deployment initiatives required by Act 183 of 2004 (Chapter 30), which will provide access to broadband service to all Pennsylvanians by 2015.

Regulated Telephone Companies

The three largest incumbent local exchange carriers (ILECs) are Verizon Pennsylvania Inc., Verizon North Inc. and The United Telephone of Pennsylvania LLC d/b/a Embarq Pennsylvania (Embarq PA). Currently, the number of telecommunications carriers certified by the Commission is follows:

Telecommunications Carriers Total: 726
Competitive Local Exchange Carriers - 174
Incumbent Local Exchange Carriers - 38
Competitive Access Providers - 95
Interexchange Carriers, Toll Facilities-Based – 72
Interexchange Carriers, Toll Resellers - 347

Mergers and Acquisitions

In reviewing mergers and acquisitions, the Commission works to make certain that customers are protected, and that the company has the requisite managerial, financial and technical capability to provide services. The PUC gives each application a thorough and comprehensive review. In Pennsylvania, the applicable legal standard mandates that an affirmative public benefit shall result from a utility merger or acquisition. Public benefit is defined typically as protecting the public interest, encouraging economic development and safeguarding the environment.

CenturyTel Inc.
On May 28, 2009, the Commission approved the merger of United Telephone of Pennsylvania LLC d/b/a Embarq Pennsylvania (Embarq PA) and Embarq Communications Inc. (ECI) and CenturyTel Inc. The PUC approved the merger with conditions including the company must:

- Maintain the same service levels for wholesale operations;
- Meet reporting requirements on the integration of billing systems and business and repair office operations as well as quality of service;
- Not protest or challenge market entry and interconnection requests by competitive local exchange carriers; and
- Incorporate FCC conditions regarding the offering of stand-alone digital subscriber line (DSL) service.

Embarq subsidiaries offer communications services to residential consumers and businesses, including local, long-distance, high-speed data wireless and video services. Embarq PA is a certificated incumbent local exchange carrier (ILEC) in Pennsylvania, serving approximately 326,078 total access lines in Pennsylvania. ECI is a certificated interexchange toll reseller, having approximately 160,000 customers in Pennsylvania. CenturyTel Inc. is a Louisiana corporation, providing communications, high-speed Internet and entertainment services in small- to mid-size cities through its broadband and fiber networks

Yukon-Waltz Telephone Co.

On May 22, 2008, the Commission approved the joint application for the transfer of control of Yukon-Waltz Telephone Co. and Yukon-Waltz Communications Inc. to Laurel Highland Total Communications Inc. The closing on the transaction was completed on Dec. 1, 2008.

The former Yukon-Waltz Telephone Co. was incorporated under the laws of the Commonwealth of Pennsylvania on Aug. 11, 1911. It had been a family owned and operated rural telephone company. The company provides local exchange telephone services as an ILEC in one rural telephone exchange to approximately 855 access lines in portions of Westmoreland County. Yukon-Waltz Communications was a wholly owned subsidiary of Yukon-Waltz Telephone Co. and was authorized to provide telecommunications services in Pennsylvania as an interexchange carrier (IXC) reseller since 1988.

Laurel Highland Total Communications Inc. is a holding company that owns Laurel Highland Long Distance Co. and Laurel Highland Telephone Co., an ILEC that has been providing local exchange telephone services since 1908 and serves two rural telephone exchanges in approximately 400-square-mile areas in Fayette and Westmoreland counties. Laurel Highland Long Distance Co. has been providing IXC reseller telephone service since 2003.

Upon the approval of the joint application and the acquisition of the Yukon-Waltz Telephone Co. capital stock, Yukon-Waltz Telephone Co. and its subsidiary Yukon-Waltz Communications became wholly owned subsidiaries of Laurel Highland Total Communications Inc.

D&E/Windstream

On May 21, 2009, Denver and Ephrata Telephone and Telegraph Co. (D&E), Buffalo Valley Telephone Co. (BVT), The Conestoga Telephone and Telegraph Co. (CTC), D&E Systems Inc. and Windstream Corp. filed a joint application for merger.

As a result of the merger, the D&E entities will become subsidiaries of Windstream and will continue to exist in their current corporate form, with the exception of a potential name change. According to the company, the transaction will not result in any transfer of assets or facilities in Pennsylvania and will be seamless to customers, who will continue to receive service from the same local company at the same terms and conditions as prior to the transaction.

5-1-1 Three-Digit Dialing

The Federal Communications Commission (FCC) has designated 5-1-1 as the universal dialing code for government entities for providing transportation and travel-related information. The Pennsylvania Department of Transportation (PennDOT) has been consulting with the Commission on the technical and legal aspects of implementing a statewide traveler information service utilizing the 5-1-1 number.

PennDOT has issued a request for proposals to design, build, implement, operate, host and maintain a service known as "511 Pennsylvania." This service will allow travelers to easily access accurate, up-to-the-minute information on traffic; roadway conditions; regional weather; transit operations; tourism information; and more via the Internet and telephone. The service "511 Pennsylvania" is scheduled to be operational in Fiscal Year 2009-10.

EAS Regulations and Working Group

The Commission's Extended Area Service (EAS) regulations govern how the Commission may requires the local telephone company to extend the local calling area – the area in which a telephone consumer can make a call without paying toll charges. The Commission is reviewing these regulations to determine whether they need to be updated to reflect changes in technology and the Pennsylvania telecommunications market, since they were first adopted prior to local telephone service competition.

The Commission is seeking input from industry and consumer groups, as well as competitors on a rulemaking to revise the regulations. It also has created an EAS Working Group to make recommendations on what, if any, future EAS regulations or policies are appropriate. The EAS Working Group held its first meeting in June 2008 and addressed, among other issues, the differences in market developments in rural Pennsylvania compared to urban areas. The EAS Working Group submitted a recommendation on the direction of the EAS policy in Pennsylvania, which is currently under consideration by the Commission.

Chapter 30 Implementation

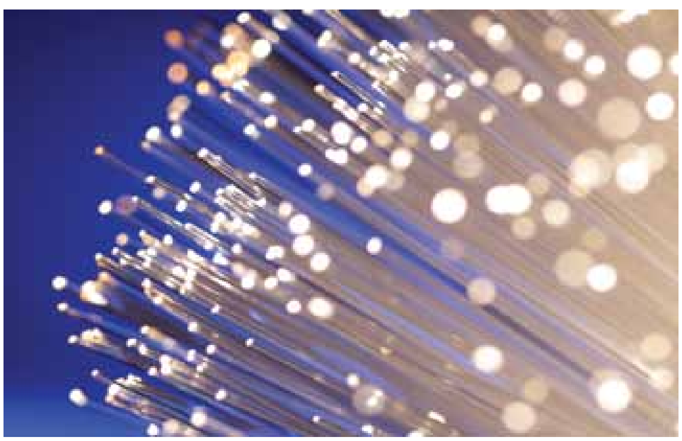
The Commission continues to implement key provisions of Act 183 of 2004, which modifies the prior Chapter 30 provisions of the Public Utility Code. Compared to pre-existing Chapter 30 regulations, Act 183 provides more economic incentives to facilitate deployment of a Statewide Broadband Network compared to pre-existing regulations, encourages earlier completion of existing network modernization plans (NMPs) by incumbent local exchange carriers (ILECs), and provides for less Commission regulation. Chapter 30 authorizes the Commission to oversee the NMPs that provide for the deployment of broadband high-speed access connections to the Internet and other services. Act 183 also reduces filing and reporting requirements for incumbent local exchange carriers, establishes a Bona Fide Retail Request program (BFRR), the Business Attraction or Retention Program (BARP), the Broadband Outreach and Aggregation Fund (BOAF) and the Education Technology Fund (E-Fund).

The Chapter 30 law provides three options for the alternative regulation and network broadband deployment for the ILECs under the Commission's jurisdiction. Twenty-nine ILECs proceeded with the implementation of broadband deployment in their respective networks. All these carriers completed their broadband commitments by Dec. 31, 2008. Most of these companies chose the opportunity to implement annual revenue rate increase changes under a price cap mechanism. This price cap formula contained an inflation offset incentive lower than the pre-existing one. The remaining four ILECs chose other alternative regulation options. Embarq PA and Windstream elected to complete their broadband commitment by 2013. Embarq PA and Windstream chose a zero percent inflation offset value in their respective price cap mechanisms, and also undertook the BFRR (Bona Fide Retail Request) program. Verizon PA and Verizon North, the only non-rural ILECs, elected to complete their broadband deployment by 2015. They chose a 0.5 percent inflation offset value in their respective price cap formulas, and also undertook the relevant BFRR program and BARP obligations.

Chapter 30 Investigative Audit Report – Verizon PA

In September 2008, the Commission released an audit report and Verizon PA's response regarding The Liberty Consulting Group's review and evaluation of Verizon PA's progress in implementing its Chapter 30 Network Modernization Plan (NMP) commitments. In mid-2007, Liberty began its work to review and evaluate the accuracy of Verizon PA's June 30, 2007, biennial NMP update, representing its implementation status as of Dec. 31, 2006. Generally, the audit found that Verizon had met most of its NMP commitments through 2006 and was compliant with the Commission's reporting guidelines. However, Liberty's report did contain 23 recommendations. In its response, Verizon indicated that it agreed with 14 recommendations, agreed in part with two recommendations and disagreed with seven recommendations. Therefore, the Commission directed that a workshop be convened between Commission staff and Verizon PA to resolve the disputed recommendations.

In February 2009, the Commission released a joint report that resolved all unsettled issues from the September 2008 independent audit of Verizon Pennsylvania Inc.'s Chapter 30 Network Modernization Plan (NMP). The joint report contains agreements between Commission staff and Verizon establishing reporting and provisioning commitment benchmarks for measuring Verizon's performance on network modernization until 2012. At that time, the Commission staff and Verizon will reconvene to establish benchmarks for the company's last two reports due in 2015 and 2016.



The joint report also resolves other issues, including: creating a method to assess Verizon's spare fiber capacity used to timely provision customer requests in the future; mechanizing the Digital Subscriber Line (DSL) and Fiber Optic Service (FiOS) facilities deployment counting process to provide a more accurate reporting of broadband availability; and more clearly defining reporting requirements and reported results. Under Verizon's NMP, it has committed to ensure 100 percent high-speed broadband availability within its service territory by 2015.

PUC-Approved Price Cap Filings

To date, 23 incumbent local exchange carriers (ILECs) adopted price caps using the gross domestic product price index (GDP-PI) outlined in Act 183 of 2004 as the inflation factor under the alternative regulation portion of their Chapter 30 Plans. As a result, the carriers file their annual price stability mechanism index either accompanied by tariffed rate changes and/or banked revenue increases/decreases. Through past settlements reached with the state's Office of Consumer Advocate, most of the ILECs are required to implement banked revenue changes in actual rates within four years or forego the revenue. Verizon PA, Verizon North and Embarq PA are required to immediately implement any rate decrease of more than $500,000. Pursuant to Chapter 30, during the period from 2005 to 2009, companies with price cap mechanisms collectively have been permitted to increase local service rates. In FY 2008-09, those were $113.517 million with total banked revenues of $28.784 million.

Bundled Services for Lifeline Participants

The Lifeline 135 program is available to qualified customers of eligible telecommunications carriers. Under the program, customers who participate in certain public assistance programs, or who have income at or below 135 percent of the federal poverty guidelines can receive a discount on their monthly local phone service for one telephone line. The discounts are paid out of the federal Universal Service Fund, which is subsidized by contributions from all telephone customers.

On July 10, 2007, the Office of Consumer Advocate, the Pennsylvania Utility Law Project and AARP Pennsylvania filed formal complaints against Verizon PA and Verizon North, alleging that the companies violated the law because their tariffs prevented Lifeline 135 customers from subscribing to any packaged or bundled offerings that included local, toll and optional services.

As a result of that complaint, the Commission ordered Verizon PA Inc. and Verizon North Inc. to also offer its customers enrolled in Lifeline 135 an opportunity to subscribe to bundled services. The companies have revised their tariffs to permit their Lifeline 135 customers to subscribe to three types of bundled services: local service with three vertical services; local service with three vertical services and regional toll; and local service with three vertical services, regional toll and long distance. In an effort to increase awareness about Lifeline, the PUC developed an informational brochure, "Follow the PATH to PA Telephone Help." The brochure provides information about Lifeline and other available programs for limited-income telephone customers.

Broadband Deployment

Pennsylvania is home to one of the country's most aggressive broadband deployment initiatives as required by Act 183 of 2004. In a report released March 4, 2008, by the U.S. Internet Industry Association, Pennsylvania's Act 183 was cited as "the most aggressive broadband deployment plan in the nation." By 2015, the Act requires that every Pennsylvanian will have access to broadband services, even in the more rural areas.

Act 183 also contains several programs designed to accelerate broadband deployment.

Bona Fide Retail Request Program

The Bona Fide Retail Request Program (BFRR) established by Act 183 of 2004 provides a means for customers to obtain broadband services sooner than they may otherwise receive them through their local telephone company's deployment schedule.

Through the BFRR, customers may demonstrate that sufficient demand for high-speed Internet service exists in their area by submitting applications to their local telephone company. When a minimum of 50 retail access lines or 25 percent of the retail access lines within a carrier serving area (whichever is less) commit to purchase broadband services for a minimum of one year, the local telephone company must make those services available in that area within 12 months. Carrier serving areas are geographic areas served by the same central office or remote terminal. Typically, a carrier serving area will be all the homes and businesses within approximately two or three miles of one of these remote terminals or central offices.

Verizon Pennsylvania (Verizon PA), Verizon North Inc. (Verizon North), The United Telephone Co. of Pennsylvania LLC d/b/a Embarq PA (Embarq PA) and Windstream Pennsylvania Inc. (Windstream) are required to offer BFRR programs under the provisions of Act 183.

Each of these four companies is required to maintain a toll-free telephone number and website containing information about their respective BFRR program. Consumers also can find more information about the BFRR program through Pennsylvania's Department of Community and Economic Development (DCED) website at www.newpa.com/broadband.

The participating companies must provide semi-annual reports to the Commission consisting of the number of requests for high-speed Internet service received during the reporting period by carrier serving areas and the actions taken by the company on those requests. The Commission is required to monitor and enforce the compliance of the participating companies with their obligations to offer and administer a BFRR program.

Chapter 30 sets limits, under which, in any given 12-month period, a company is not required to work on more than 40 active BFRR requests and is not required to work on more than 20 such requests that "require property acquisition, including rights-of-way, or new construction." The two Verizon companies and Embarq PA have filed certifications stating that they have met both the 40 overall and 20 major build statutory thresholds.

Business Attraction or Rentention Program

In addition to a BFRR, Verizon PA, Verizon North, Embarq PA and Windstream are required to implement a BARP. The Business Attraction or Retention Program (BARP) permits DCED to aggregate customer demand and facilitate the deployment of advanced or broadband services to qualifying businesses that DCED seeks to attract or retain in the Commonwealth. Under this program, DCED may submit requests to the applicable company on behalf of qualifying businesses in areas that DCED deems priority areas for economic development. The Commission is required to monitor and enforce the compliance of participating companies with their obligations under the BARP.

Education Technology Program

The Act requires the Department of Education to create the Education Technology Program to provide grants to school entities from the Education Technology Fund (E-Fund) to purchase or lease telecommunications services and equipment related to broadband.

Applicant schools must be able to match their E-Fund grants.

Broadband Outreach and Aggregation Program

To further broadband deployment, this program was established by DCED as mandated in Chapter 30. This program makes expenditures and provides grants from the Broadband Outreach and Aggregation Program (BOAF). The fund is for outreach programs for business and residential consumers, political subdivisions, economic development entities, schools and health-care facilities concerning the benefits, use and procurement of broadband services, and seed grants to aggregate customer demand.

The Commission receives an annual report from DCED to verify the accuracy of the contributions from the four participating ILECs.

Promoting Broadband Access and Education

In order to finance the E-Fund and BOAF, the Act requires the Commission to annually assess the four ILECs opting to complete their broadband buildout in 2013 or 2015; such assessments are established to be 20 percent of the first year's annual revenue effect of any rate increase gained from the elimination or reduction in the inflation offset in the carriers' NMP formula. The acquired funds are divided equally between the E-Fund and the BOAF until June 30, 2011, when the E-Fund is terminated. Thereafter, the assessment is reduced to 10 percent until the participating ILEC achieves full broadband deployment or until the termination of the BOAF on July 1, 2016. At no time may the BOAF exceed $5 million. In June 2009, the Commission approved a BOAF fund size of $1.698 million for Fiscal Year 2009-10.

The E-Fund also receives an assessment from the non-rural ILECs (Verizon PA and Verizon North) based on their access line apportionment. For the fiscal years 2005-06 and 2006-07, the annual assessments were $7 million. For the fiscal years 2007-08 through 2010-11, each year's assessment is the difference between

$7 million and any unencumbered amount remaining in the E-Fund. In addition, the Verizon companies expressed a commitment in 2004 to Gov. Rendell that, if the assessment amounts for E-Fund were less than $10 million, the Verizon companies would provide an additional contribution of up to $3 million annually to make up the difference during the life of the fund. Verizon PA's additional contribution for the 2009-10 fiscal year is $1.148 million, while Verizon North's is approximately $153,800.

PA Universal Service Fund

The PA Universal Service Fund (PaUSF) supports the affordability of basic local telephone service that is provided by rural ILECs in Pennsylvania. The administrator of the PaUSF is Solix Inc. The company is under contract with the Commission to administer the fund through Dec. 31, 2010, with a possible one-year extension. Withum, Smith & Brown submitted an auditor's report dated June 17, 2009, on the fund's activities during 2008. This report is on the PUC's website at www.puc.state.pa.us.

The Commission approved a state USF contribution rate for 2009 calculated to produce approximately $33.834 million to be distributed among recipient carriers. The amount is collected via assessments against telephone company intrastate retail revenues from the prior year. All PUC-jurisdictional telecommunications companies are assessed and file annual intrastate retail revenue reports with Solix that are used for calculating the assessment rate for the upcoming year. All incumbent LECs in Pennsylvania except Verizon PA, Verizon North (formerly GTE North), and Denver and Ephrata Telephone and Telegraph Co. (D&E Telephone) are annual net recipients from the Fund.

Eligible Telecommunications Carriers

Carriers that provide telecommunications service must be deemed "eligible" by their respective state commissions or the Federal Communications Commission (FCC) in order to receive payments out of the Federal Universal Service Fund to defray the cost of delivering discounted services to consumers. This type of carrier is known as an eligible telecommunications carrier or ETC.

The Federal Universal Service Fund was established by the FCC in 1983 to help keep local telephone service affordable in a competitive telecommunications market by assessing access lines nationwide and providing subsidies to carriers in high-cost areas. The federal fund is separate from the PA Universal Service Fund.

Carriers granted ETC status are eligible to receive federal universal service funding support, which helps maintain affordable local telephone service for all Americans and provides discounted service to schools, public libraries and low-income customers.

In February 2009, the Commission opted to actively and affirmatively exercise its jurisdiction over ETC designations for wireless carriers by determining whether a wireless carrier qualifies as an ETC in Pennsylvania. All filings related to ETC designation in Pennsylvania must be filed and approved by the PUC.

The Commission will evaluate wireless ETC requests to ensure that wireless carriers seeking ETC status will comply with public safety and other requirements consistent with the broader public interest. Previously, the PUC had deferred to the Federal Communications Commission for making wireless ETC designations. The Commission currently exercises its ETC designation authority with respect to incumbent local exchange carriers (ILECs), competitive local exchange carriers (CLECs) and wireless carriers.

Access Charge Proceedings

Access charges are the charges assessed by a local exchange carrier (LEC), typically an Incumbent Local Exchange Carrier (ILEC), on interexchange carriers (IXC) and other Local Exchange Carriers (LECs), typically Competitive Local Exchange Carriers (CLECs), for access to the ILECs' networks to complete an IXC or CLEC customer call. This compensation structure ensures that the ILEC is properly compensated for network costs incurred to complete a call, typically a long-distance interstate or intrastate call.

Prior to the advent of access charges, the monopoly era practice was for ILECs to collect revenues from end-users making long-distance calls. Those charges were often at or above cost whereas the charges collected for a local call were often at or below cost.

This monopoly pricing structure helped keep local rates affordable while providing ILECs with revenues from long-distance calling to maintain their profitability. As competition replaced monopoly regulation, regulators required carriers to provide CLECs and IXCs access to their networks with the proviso that the IXC or CLEC had to pay the ILEC "access charges" to use the ILEC's network. As state and national policy continued to favor competition, the ILECs ability to rely on "access charge" or "long distance calling" revenue came under strain. That was because their charges were often above cost whereas competitor IXCs or CLECs were able to charge less because they served fewer customers or did not have to incur costs to serve lower-cost urban and higher-cost rural areas at the same time.

Between 1984 and 1999, the Commission worked toward transitioning switched access charges to cost-based levels in three ways. First, ILECs were allowed to reduce their access charges as part of a general rate case. Second, ILECs could reduce their access rates through revenue neutral rate rebalancing filings. Finally, ILECs could reduce access rates in Chapter 30 annual price change opportunity filings that resulted in annual revenue decreases for a particular year.

Consequently, the Commission's policy on access charge pricing continues to evolve because it requires attempts to reconcile the decreased ability to rely on access charges with an efforts to maintain reasonable rates for local service in higher-cost rural areas and lower-cost urban areas. Nevertheless, the Commission

gradually reduced access charges even though the resulting revenue loss has triggered local rate increases.

Of these efforts, the most significant was the Commission's 1999 Global Order. The Global Order implemented substantial access charge reductions by providing for major scheduled reductions in the LECs' switched access charges. The Global Order also provided for future investigations to determine whether further access charge reductions should be implemented. Despite the extensive intrastate carrier access charge reforms that have been carried out in Pennsylvania, the LECs' switched carrier access charges are still generally above their federal levels.

The Commission is permitted to reduce access rates but only on a "revenue neutral" basis. This means that any revenue lost from access rate reductions must be made up with revenue from another service or source, probably local rates. CLECs or IXCs also are prohibited from charging access rates greater than an ILECs unless those charges are justified by cost.

Currently, three related access charge proceedings are underway at the Commission, they are:

• **Rural Telcos Access Charge Investigation** – The Commission lifted a three-year stay on further access charge proceedings. The Commission also consolidated 96 separate formal complaints that competitors had filed against each of the rural telcos' access charges into the same proceeding. The formal complaints allege that the rural Telcos access charges are unjust or unreasonable. Evidentiary hearings are being conducted and a Recommended Decision is set for August 2010.

• **USF Proceeding** – The Commission reopened a proceeding in early 2008. This proceeding was re-opened for the limited purpose of addressing whether the monthly Universal Service Residential One-Party Service Rate Cap of $18 should be raised and to consider other Pennsylvania Universal Service Fund issues. A Recommended Decision on this phase of the investigation was issued and is presently pending before the Commission for final consideration.

• **Verizon Companies Access Charge Investigation** – This action was stayed pursuant to a September 2008 Commission Order. However, status reports addressing whether there is a need for a further stay will be filed later this year and the Commission will determine whether the stay on this investigation should remain or be vacated upon its review of the reports.

In addition to those major access charge proceedings, the Commission has reviewed numerous complaints from various types of telephone carriers against ILECs involving the application and payment of access charges. Some of these filings claim that access payments should or should not be paid based on current federal classification of the service. Other filings concede that payment may be appropriate but insist that intrastate access rates, the highest rate collected by many ILECs, are not appropriate but that reciprocal compensation rates, the lowest rate collected for local calling, is the appropriate rate. These proceedings arise because of uncertain regulatory direction from the Federal Communications Commission (FCC).

PUC Involvement at the FCC

Federal telecommunications regulation by the FCC is playing an increasingly important role in the delivery of telephone service in Pennsylvania. This requires the Commission to expend resources and be much more actively involved in FCC proceedings compared to previous years. The Commission is currently involved in proceedings at the FCC regarding several important issues that directly impact Pennsylvania consumers including:

• **The National Broadband Plan** is a proceeding in which the FCC is seeking input from the public as part of an FCC report to Congress on what measures are needed to deploy broadband and support broadband services throughout the nation, particularly in rural areas. The FCC claims that federal stimulus will probably be insufficient to attain rural broadband deployment so other support may be required, including support from the Federal Universal Service Fund (FUSF). The FCC planned to submit this report to Congress in February 2010 but recently asked for a one-month extension.

The Commission has submitted comments to the FCC, particularly given the very large increase in the FUSF (conservatively estimated at $40 billion) that may be required if the FCC decides to support broadband deployment and services from the FUSF. Currently, Pennsylvania contributes $176 million more into the FUSF than it gets back. The Commission is very concerned that this net $176 million contribution to support the current $7.1 billion FUSF fund may grow astronomically if $40 billion in additional broadband deployment and services costs are funded by the FUSF without reform of the FUSF.

The Commission urged the FCC to require that any state receiving any support for broadband deployment or services be required to implement measures similar to those undertaken in Pennsylvania under Chapter 30. Recipients should be required to get support from end-users as a precondition to getting FUSF support. The Commission reminds the FCC that Pennsylvania has the nation's third largest rural population and successfully completed a broadband deployment program in all but two rural carriers' service territories by 2009. The Commission also reminds the FCC that the remaining two rural carriers are on schedule to complete their broadband deployment programs no later than 2013 and that Verizon will complete their deployment by 2015.

• Universal Service is the term used for the FCC's efforts to provide federal universal service fund (FUSF) support to carriers so that reasonable local rates can be maintained in high-cost areas, typically rural areas. The FUSF is supported by an assessment on carriers' interstate calling revenues. Those revenues have declined due to technological change even as the FUSF costs have increased.

The four parts of the FUSF are High-Cost, Schools and Libraries, Rural Health and Low Income. Pennsylvania currently pays $176 million more into the FUSF than it receives although some rural carriers do receive more in support than they pay. The FCC is examining ways to limit burgeoning FUSF costs, particularly for the High-Cost and Low-Income programs. The FCC is also considering including broadband deployment as a new program initiative within the FUSF.

The Commission actively has participated in order to minimize increased costs to Pennsylvania, including costs for any national broadband deployment program. As mentioned previously, the Commission is particularly concerned that the current FUSF fund may grow by an additional $40 billion if broadband deployment and services are fully supported by the FUSF. The Commission also is concerned that any federally mandated reductions in carrier revenues may result in local rate increases, particularly if there are reductions in access rates that require revenue neutral recovery under Section 3017(a) of Chapter 30,

• Intercarrier Compensation is the term used for the payments that telephone companies and their competitors pay each other to use each other's networks. The three forms of compensation are interstate access rates (for interstate long-distance calls), intrastate access rates (for in-state long-distance calls), reciprocal compensation (for in-state local calls) and bill and keep compensation (each carrier pays its costs for call completion). Currently, reciprocal compensation is the lowest rate, interstate access rates are next, and intrastate access rates are the highest.

The FCC proposed establishing a national compensation rate for all calls at one rate, including the rate for local and in-state long distance calls traditionally set by the states. The FCC claims this is necessary in order to prevent carriers from classifying calls in order to receive a more favorable compensation. The Commission is active in this proceeding and awaiting further FCC action.

• Forbearance is the term used for the authority the FCC has to "waive" or "set aside" state or federal laws and regulations on reporting requirements and competitor access to facilities. The FCC recently granted forbearance from statutory obligations to report on customer satisfaction and carrier investment in their networks although, in that decision, the FCC also opened a new rulemaking. The Commission actively has opposed any forbearance that would undermine the General Assembly's authority to address service quality or network investment.

In June 2009, the FCC issued a series of rules outlining the procedure governing future forbearance proceedings. The FCC rules adopted a "complete as filed" regulation and put limits on a petitioner's ability to unilaterally withdraw forbearance requests. The FCC's final rules reflect many proposals submitted by the Commission in partnership with other state commissions in the Middle Atlantic Region.

Voice over Internet Protocol and 911 Legislation

The Pennsylvania General Assembly adopted Senate Bill 1000 as Act 52 in July 2008, which offered direction regarding jurisdiction of Internet Protocol (IP) enabled services, including Voice over Internet Protocol (VoIP).

The FCC is currently considering competition for 911 services that may have an impact on Pennsylvania in the future.

PA Telecommunications Relay Service Program, Telecommunications Device Distribution Program and Print Media Access System Program

During Fiscal Year 2008-09, the Bureau of Audits initiated its second audit of underlying costs of the Telecommunications Relay Service (TRS) program. The audit covers the fiscal years ending June 30, 2006, and June 30, 2007. The Bureau of Audits also has initiated the audit of the TRS program's receipt and disbursement of

funds received from the billing of the applicable TRS surcharge rates for the fiscal years ending April 30, 2007, and April 30, 2008, and the fiscal period ending Feb. 29, 2009. Also during this fiscal year, the Bureau of Audits completed its audit of the underlying costs of the Telecommunications Device Distribution Program (TDDP), as well as the Print Media Access System Program (Newsline) for the fiscal year that ended June 30, 2007. Audits of these programs will continue on an ongoing basis.

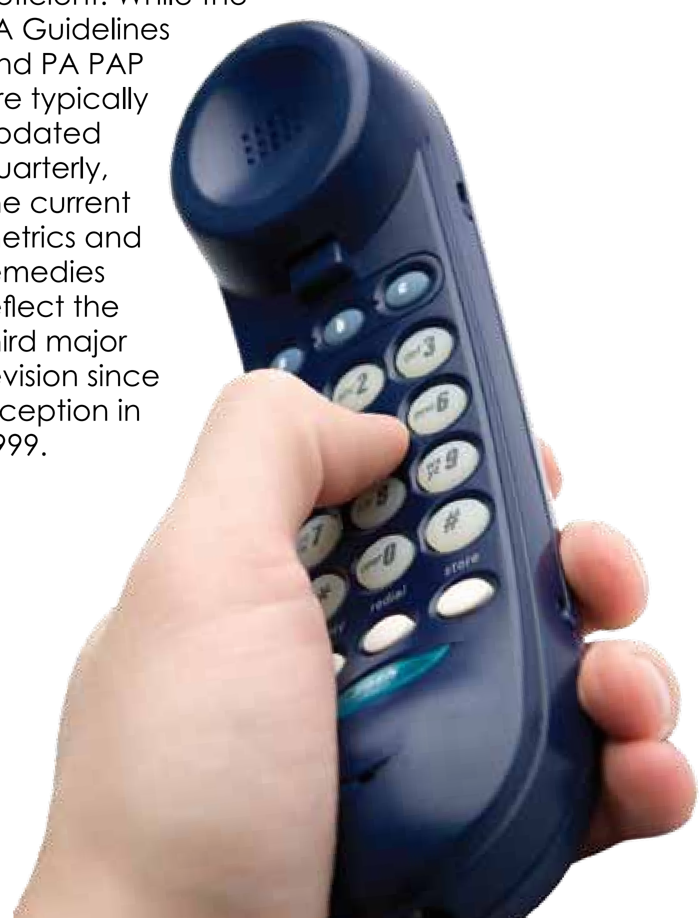
TRS, TDDP and Newsline continue to be funded from the TRS monthly surcharge on wireline access lines. The goal is to provide functionally equivalent access to telecommunications and print media. AT&T has provided traditional TRS in the state since 1990. Technological advances since then have established Captioned Telephone Relay Service (CTRS) as an alternative to traditional TRS for individuals with some degree of hearing within the speaking segment of the deaf and hard-of-hearing community. CTRS is also funded by the TRS surcharge.

TDDP, instituted in 1996, provides free telecommunications devices for members of the community who meet eligibility requirements relating to disability, income level, age and residence. Newsline, instituted in 2005, is an on-demand, newspaper reading service for the blind and others who cannot physically read a newspaper, accessible via toll-free telephone lines. The Commission has completed the annual recalculation of the TRS surcharge as it applies to residence and business wireline access lines for Fiscal Year 2009-10 (See also Consumers).

Verizon's Performance Issues

The PA Carrier Working Group (CWG) – comprised of Commission staff, Verizon PA, competitive local exchange carriers (CLECs), the Office of Consumer Advocate, the Office of Small Business Advocate, and other interested parties – focuses on the quality of the wholesale service (e.g., interconnection) that Verizon renders to the CLECs. The PA CWG also works with similar CWG groups throughout the Verizon footprint to resolve issues in a manner consistent with Verizon and the CLECs' multi-state operations. Work is ongoing in the PA CWG on PA-specific operations and problems, as well as incorporating footprint changes into the way service is measured in PA.

Verizon's wholesale service is evaluated using metrics that measure Verizon's wholesale service against Verizon's retail service or against benchmarks if there is no comparable retail service, as detailed in the PA Carrier-to-Carrier (C2C) Guidelines. Self-executing remedies, as detailed in the PA Performance Assurance Plan (PAP), are generated if it appears that the wholesale service was deficient. While the PA Guidelines and PA PAP are typically updated quarterly, the current metrics and remedies reflect the third major revision since inception in 1999.



Numbering Plans

The North American Numbering Plan Administrator, "NeuStar Inc" (Neustar), which is the neutral third party Number Planning Area (NPA) relief planner for Pennsylvania, petitioned the PUC on behalf of Pennsylvania's telecommunications industry because the 570 and 814 area codes are projected to run out of telephone numbers. New area codes are needed when existing area codes exhaust their supply of "NXX" codes (which is the second set of three digits in a 10-digit telephone number, NPA-NXX-XXXX).

The 570 and 814 area codes are expected to exhaust its supply of telephone numbers by the third quarter of 2011 and the third quarter of 2012, respectively. Different relief alternatives are suggested for ensuring adequate number resources. The alternatives include an overlay of a new area code and various geographic splits of the existing area codes. The petition filed by Neustar before the PUC recommended an "overlay" plan, which means once the existing telephone numbers in the 570 and 814 area codes are exhausted, new telephone services in that geographic region would be assigned telephone numbers out of the new area code. Ten-digit local dialing would then apply to all telephone calls.

The Commission is expected to open a public comment period on the issue and hold public input hearings. In Fiscal Year 2009-10, the PUC anticipates that NeuStar also will file petitions on the 717 area code because of projections that it will exhaust its supply of telephone numbers.

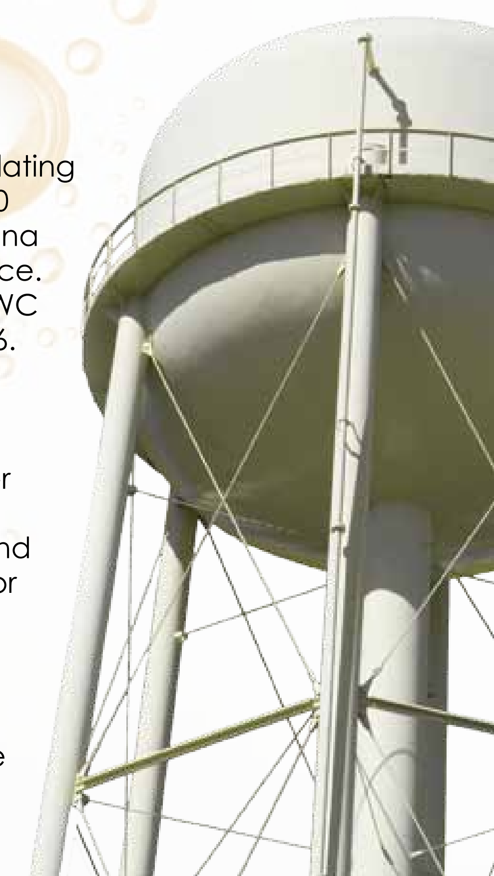
WATER/WASTEWATER

The PUC regulates the rates and service of investor-owned water and wastewater companies, along with some municipal systems that serve customers outside their boundaries. Since viable water systems are essential to strong Pennsylvania communities, rates must be set to reflect prudently incurred costs of providing service.

The Commission regulates the rates and service of about 193 water and wastewater companies, including a number of municipal water and wastewater systems. In Fiscal Year 2008-09, the Commission acted on 20 water and wastewater rate increase requests. The Commission also processed 41 applications for Certificates of Public Convenience, including requests for additional territory, abandonments, formation of new companies, mergers and acquisitions.

The Commission has established a water audit pilot program, which is intended to enhance the companies' tracking of levels of unaccounted-for water. It is designed to provide an effective, standardized structure by guiding the water utility to quantify apparent and real loss volumes in a systemized approach and assigning cost impacts to the losses. As part of its investigation related to a high number of water outages in the Pittsburgh area in 2006, this fiscal year the Commission issued the second of two reports outlining Pennsylvania American Water Company's response to the outages, availability of resources, timeliness of public notice and other reliability issues. Additionally, the Commission has focused on emergency response planning by requiring that companies annually certify that their physical and cybersecurity, emergency response and business continuity plans are current through ongoing audits of these plans. These plans are also subject to periodic on-site reviews.

PAWC Outages in the Pittsburgh Area



During Fiscal Year 2008-09, the Commission released the second report relating to the extended service outages that arose in November 2006 when 2,000 Pennsylvania American Water Company (PAWC) customers in Lackawanna County and other portions of PAWC's service territory lost their water service. These outages were in addition to similar outages that affected 1,000 PAWC customers in the Pittsburgh area, including two schools, in December 2006.

As a result of those events, the Commission initiated an investigation in December 2006, to examine the utility's compliance with the Public Utility Code and the Commission's regulations regarding safe and reliable water service in the Commonwealth. The Commission did so because of its fundamental duty to ensure that public utilities provide safe, adequate and continuous service to their customers without unreasonable interruptions or delay, in accordance with regulations and orders.

The Commission's investigation was to include a determination as to whether PAWC responded to the outages in an effective and timely manner; adequate resources were available to effectively respond to the situation in a timely manner; the public received adequate notice and were kept informed in a timely manner; emergency response officials received notice and were kept informed in a timely manner; and adequate supplies of drinking water were provided and/or available at convenient locations.

The Commission prepared a report relating to the Pittsburgh outages that contained 15 directives for PAWC to implement. After releasing the report for public comment, the Commission's Final Order on the Pittsburgh outages was entered on July 26, 2007. The second report relating to the extended outages in Lackawanna County and other portions of PAWC's service territory was issued for public comment on Oct. 9, 2008, with the Commission's Final Order on the Lackawanna County outages entered on Oct. 30, 2008.

Rate Increase Requests

During the fiscal year, the Commission took the following actions related to about $44.4 million in rate increase requests:

Aqua Pennsylvania Inc. (water)

Customers Served: 403,235 in portions of many counties throughout the state
Requested Rate Increase: $41.7 million (13.6 percent)
Approved Rate Increase: $34.4 (11.2 percent)
Primary Reasons: As a result of the company's investment to improve water quality, service and reliability

Blue Knob Water Co.

Customers Served: 284 in portions of Bedford and Blair counties
Requested Rate Increase: $114,374 (216 percent)
Approved Rate Increase: $53,521 (100.4 percent)
Primary Reasons: To enhance its financial position to support capital investment

Borough of Fairchance (water)

Customers Served: 1,262 in the Borough of Fairchance and Georges Township, Fayette County
Requested Rate Increase: $58,597 (16 percent)
Approved Rate Increase: $22,540 (6 percent)
Primary Reasons: To provide for increased costs of operation and maintenance expenses

Can Do Inc. (wastewater)

Customers Served: 60 in Butler and Hazle townships, Luzerne County
Requested Rate Increase: $362,010 (50 percent)
Approved Rate Increase: $362,010 (50 percent)
Primary Reasons: To provide for repayment of a Pennsylvania Infrastructure Investment Authority (PennVEST) loan and to cover increased operating costs

Clarendon Water Co.

Customers Served: 329 in Borough of Clarendon, Warren County
Requested Rate Increase: $38,842 (41 percent)
Approved Rate Increase: $21,684 (21 percent)
Primary Reasons: To fund increased operation and maintenance costs

The Columbia Water Co.

Customers Served: 8,690 in portions of Lancaster County
Requested Rate Increase: $616,402 (16.5 percent)
Approved Rate Increase: $311,783 (8.2 percent)
Primary Reasons: To realize a reasonable rate of return on the company's fixed capital investment and recover increased operating expenses

Exit II WWTP Inc. (wastewater)

Customers Served: 19 in Shrewsbury and Springfield townships, York County
Requested Rate Increase: $77,500 (77.6 percent)
Approved Rate Increase: $31,113 (31.1 percent)
Primary Reasons: To provide for increased costs in operating expenses and the need to make significant improvements

Hyndman Borough Water Co.

Customers Served: 462 in Borough of Hyndman and Londonderry Township, Bedford County
Requested Rate Increase: $1,288 (27.1 percent)
Approved Rate Increase: $1,320 (27.8 percent)
Primary Reasons: To provide for the increase in operating expenditures, improvements to the water treatment plant and for repayment of a PennVEST loan

Manwalamink Sewer Co.

Customers Served: 1,217 in Smithfield and Middle Smithfield townships, Monroe County
Requested Rate Increase: $78,100 (30 percent)
Approved Rate Increase: $78,100 (30 percent)
Primary Reasons: To allow for a nominal rate of return on the utility's investment in a utility plant

Newtown Artesian Water Co.

Customers Served: 10,105 in portions of Bucks County
Requested Rate Increase: $695,802 (14.9 percent)
Approved Rate Increase: $420,000 (8.9 percent)
Primary Reasons: To realize a reasonable rate of return on capital investment and recover increased operating expenses

Pennsylvania American Water Co. – City of Coatesville Division (wastewater)

Customers Served: 5,893 in portions of Chester County
Requested Rate Increase: $2.6 million (111.3 percent)
Approved Rate Increase: $1.85 million (76.6 percent)
Primary Reasons: To permit the company to preserve public health and safety, maintain the integrity of its capital at reasonable costs, and realize a fair rate of return

Rock Spring Water Co.

Customers Served: 463 in Ferguson Township, Centre County
Requested Rate Increase: $42,545 (46.6 percent)
Approved Rate Increase: $38,829 (42.5 percent)
Primary Reasons: To obtain additional funds to maintain and update the system

Superior Water Co.

Customers Served: 3,074 in portions of Berks County
Requested Rate Increase: $599,771 (35 percent)
Approved Rate Increase: $522,500 (30.6 percent)
Primary Reasons: To restore the company's rate of return and net operating income to a reasonable level, allowing for recovery of a return on increased investments

Total Environmental Solutions Inc. – Treasure Lake Water Division

Customers Served: 5,440 in Sandy Township, Clearfield County
Requested Rate Increase: $272,121 (45.7 percent)
Approved Rate Increase: $8,128 (1.4 percent)
Primary Reasons: To realize a reasonable rate of return on the company's fixed capital investment and to recover increased operating expenses

Total Environmental Solutions Inc. - Treasure Lake Wastewater Division

Customers Served: 5,481 in Sandy Township, Clearfield County
Requested Rate Increase: $286,615 (29.5 percent)
Approved Rate Increase: $73,318 (7.5 percent)
Primary Reasons: To realize a reasonable rate of return on the company's fixed capital investment and to recover increased operating expenses

Total Environmental Solutions Inc. – Beech Mountain Lakes Sewer Division

Customers Served: 991 in Butler, Dennison and Foster townships, Luzerne County
Requested Rate Increase: $118,920 (28.6 percent)
Approved Rate Increase: $118,920 (28.6 percent)
Primary Reasons: To allow the company to pass through increased charges for treatment services

Warwick Drainage Co.

Customers Served: 25 in St. Peter's Village, Warwick Township, Chester County
Requested Rate Increase: $21,858 (101 percent)
Approved Rate Increase: $21,600 (100 percent)
Primary Reasons: To restore the company's rate of return and net operating income to a reasonable level, allowing for recovery of a return on increased investments

Warwick Water Works Inc.

Customers Served: 25 in St. Peter's Village, Warwick Township, Chester County
Requested Rate Increase: $22,227 (171 percent)
Approved Rate Increase: $21,600 (166 percent)
Primary Reasons: To restore the company's rate of return and net operating income to a reasonable level, allowing for recovery of a return on increased investments

The York Water Co.

Customers Served: 60,458 in portions of Adams and York counties
Requested Rate Increase: $7.086 million (21.37 percent)
Approved Rate Increase: $5.95 million (17.94 percent)
Primary Reasons: To recover the costs of providing water service, to furnish adequate, safe and reliable service, as well as to maintain facilities and receive a reasonable rate of return

At the end of Fiscal Year 2008-09, 13 rate increase requests still pending before the Commission included: Birch Acres Water Works Inc. ($15,804); Can Do Inc. – Water Division ($176,913); Cooperstown Water Co. ($13,998); Fryburg Water Co. ($29,974); Lake Spangenberg Water Co. ($92,292); Little Washington Wastewater Co. – Bridlewood Division ($97,411); Little Washington Wastewater Co. – Deerfield Knoll Division ($20,522); Little Washington Wastewater Co. – East Bradford Division ($17,819); Little Washington Wastewater Co. – Links at Gettysburg Division ($34,469); Little Washington Wastewater Co. – Northeast PA Consolidated Division ($633,942); Needmore Water Supply Co. ($53,335); Pennsylvania American Water Co. ($58.062 million); and Sugarcreek Water Co. ($4,686)

PAWC Water Pressure Increases

In June 2009, the Commission approved a settlement that will allow the Pennsylvania American Water Co. (PAWC) to proceed with planned water pressure increases in portions of Cumberland County. The settlement allows the company to move forward with incremental water pressure increases on an agreed-upon schedule that is designed to ensure minimum disruption of water service.

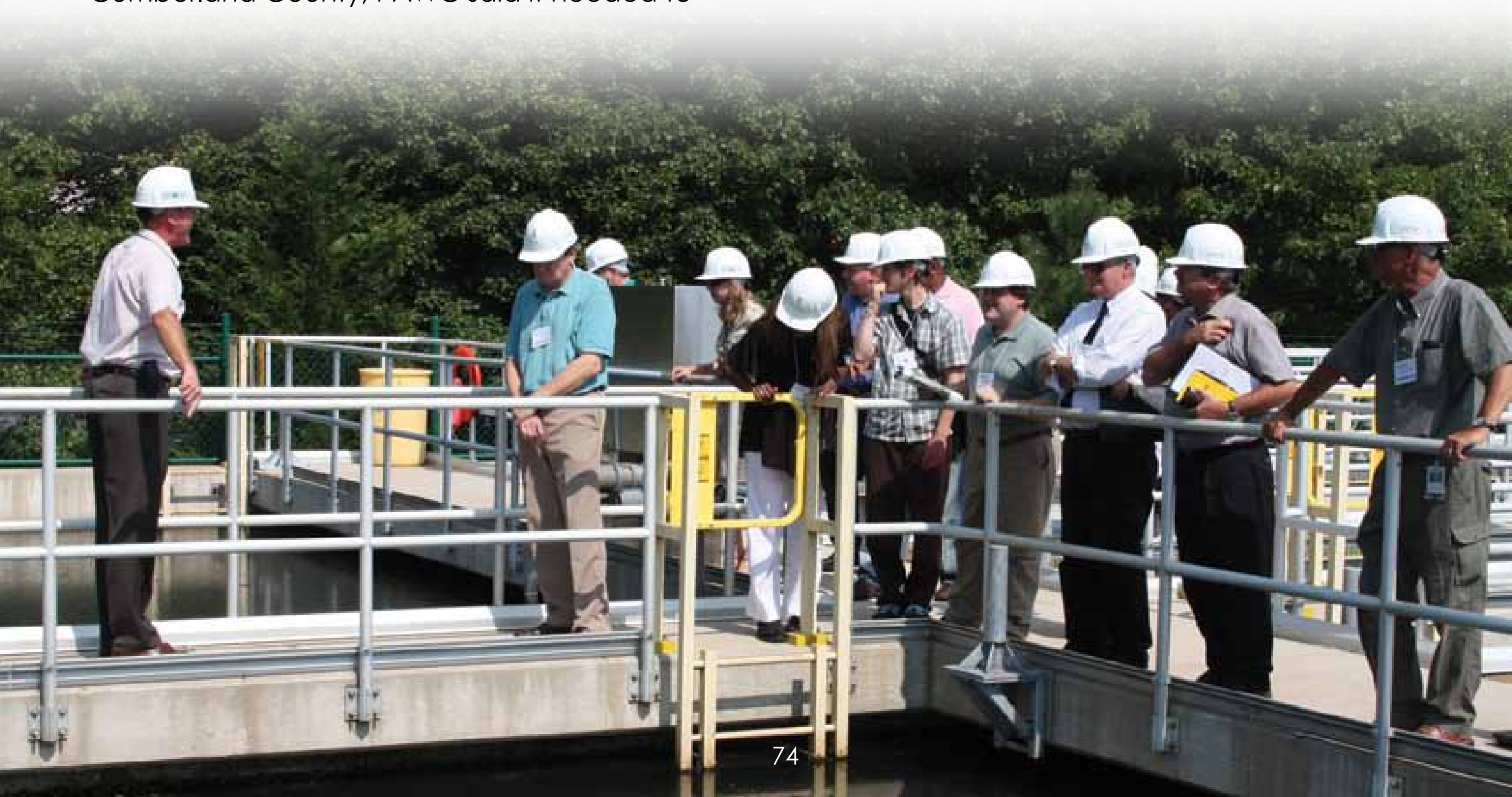
The settlement also increases communications between the company, emergency service providers and consumers; provides for after-the-fact monitoring and recognition that the water system in the area should receive additional technical considerations; ensures sufficient standby resources to respond to pressure-related events; provides for additional line monitoring and personnel during the increases; and establishes the circumstances where PAWC will use its contractors to repair damage to lines and pipes if due to pressure increases.

The settlement was reached among the company, the Office of Consumer Advocate, Camp Hill Borough, and Lower Allen and Hampden townships. As the final part of a $60 million infrastructure improvement project in Cumberland County, PAWC said it needed to increase the system's water pressure to address, among other things, complaints of low pressure and to improve fire protection. Beginning in November 2008, the municipalities filed various objections to the water pressure increases with the PUC due to water main breaks. The PUC ordered PAWC to stop the increases to allow for hearings to address the municipalities' concerns. The parties then reached a settlement.

Distribution System Improvement Charge

The distribution system improvement charge (DSIC), currently utilized by six jurisdictional water utilities, is designed to provide ratepayers with improved water quality; greater rate stability; increased water pressure; fewer main breaks; fewer service interruptions; and lower levels of unaccounted-for water. The DSIC allows water companies to use a surcharge to fund more upgrades of aging infrastructure than would otherwise be feasible at a reasonable rate for customers.

Implemented in 1997, the DSIC enables companies to recover certain infrastructure improvement costs between base rate cases



through a surcharge on customers' bills. The cost is small when compared to the noticeable benefits, with approximate average monthly costs to ratepayers ranging from a few cents a month to $2.75. Today, because of the DSIC, projected timeframes for upgrades of entire distribution systems range from 117 years to 160 years to more closely match that of actual service lives. During the fiscal year, the Commission completed three DSIC audits in addition to reviewing and processing 24 quarterly DSIC surcharge adjustment filings. Because of the success of the DSIC, one of the Commission's legislative priorities is to have a collection system improvement charge (CSIC) put into place for the wastewater companies.

PAWC Chloramine Settlement

In May 2009, the Commission approved a settlement on the plan by Pennsylvania American Water Company (PAWC) to use chloramines in its West Shore Regional Treatment Plant, York County, and Silver Spring Water Treatment Plant. The Commission found that the settlement was in the public interest because the company will take actions that address concerns raised by customers in a complaint proceeding.

In September 2007, several complaints were filed against PAWC by customers in response to the company's announcement that it intended to convert the facilities from chlorinated water to chloraminated water. The Pennsylvania Department of Environmental Protection (DEP) had issued permits to PAWC that approved the plan.

PAWC filed preliminary objections asking that each complaint be dismissed by the Commission for lack of subject matter jurisdiction. An initial decision granting PAWC's preliminary objections and dismissing the complaints for lack of jurisdiction was issued Oct. 5, 2007. Exceptions were filed by 23 complainants, and the state's Office of Consumer Advocate, followed by reply exceptions by PAWC.

On March 13, 2008, the Commission voted to grant the request of the PAWC customers to hold hearings on the health and safety impacts of PAWC's decision to treat its water in Cumberland and York counties using chloramines. Those hearings were held during the second quarter of Fiscal Year 2008-09.

Water Audit Pilot Program

In December 2008, a water audit pilot program was implemented to enhance the companies' tracking of levels of unaccounted-for water, which is water that is lost between the treatment plant and sale to customers. The water audit is designed to provide an effective, standardized structure by guiding the water utility to quantify apparent and real loss volumes in a systemized approach and assigning cost impacts to the losses. The voluntary pilot program would further overall infrastructure reliability, help preserve water resources, limit water leakage and enhance customer service. The initial meeting was held in February 2009 followed by a workshop held in early Fiscal Year 2009-10, where presentations were provided by two individuals who have familiarity with the water audit software.

Mergers & Acquisitions

In reviewing mergers and acquisitions, the Commission works to make certain that customers are protected and the company is a viable public utility and a good neighbor. The PUC gives each application a thorough and comprehensive review. In Pennsylvania, the legal standard asks whether an affirmative public benefit will result from the merger or acquisition. Public benefit is defined typically as protecting the public interest, encouraging economic development and safeguarding the environment.

The following proceedings were recently before the Commission in the water industry:

Emlenton Water Co.

In December 2008, the Commission approved a sales agreement that approved the sale of Emlenton Water Co. (Emlenton) to Aqua Pennsylvania Inc. (Aqua PA).

A boil water advisory was issued by the state's Department of Environmental Protection (DEP) for Emlenton customers in April 2008. In response to a joint application by DEP and the state's Office of Consumer Advocate, the Commission ordered on Nov. 20, 2008, that an interim certified operator be designated to manage the system. Aqua PA was designated as the operator.

As part of the sales agreement, the rates Aqua PA would be allowed to charge would take effect after the boil water advisory had been lifted. Additionally, as part of the agreement, any and all proceeds remaining after Emlenton's satisfaction of all mortgages, judgments and liens would be held by Emlenton and applied to satisty 1) customers that are entitled to reimbursement for Emlenton's misapplication of its tariff; 2) the 2008 utility assessment billed to Emlenton; and 3) any and all outstanding formal complaints on file with the Commission against Emlenton.

Aqua PA serves about 1.3 million people throughout Pennsylvania. The company operates three major regional divisions: Southeastern Pennsylvania, Central and Northern Pennsylvania, and Western Pennsylvania.

Washington Park Water Co. and Washington Park Sanitary Co.

On March 26, 2009, the Commission approved a settlement in a proceeding where Aqua PA sought to purchase Washington Water Co. (WP Water) and Washington Park Sanitary Co. (WP Sanitary).

Under the settlement, the assets of WP Water, which includes the Sleepy Hollow Water System, will be transferred to Aqua PA. In addition, a plan was submitted that includes improvements to the Sleepy Hollow system and to the WP Water system. The assets of WP Sanitary will be transferred to Aqua's Little Washington Wastewater Co., and an improvement plan was also submitted for this system. Additionally under the settlement, WP Water and WP Sanitary customers will receive refunds.

WP Water and WP Sanitary had provided service to about 150 customers in the development of Washington Park, Wyoming County.

Policy Statement on Acquisition Incentives

The PUC continues to implement a long-standing policy on water and wastewater system acquisition incentives to promote water system viability and regionalization.

The policy statement provides additional guidance for companies acquiring small, chronically challenged or otherwise troubled water systems, while ensuring fair treatment of customers. It also provides direction on when and how utilities interested in making an acquisition should prepare and submit original cost documentation that determines the appropriate value of the assets of an acquired system.

The Commission has a policy of encouraging well-operated water and wastewater utilities to regionalize or consolidate with smaller systems. The limited resources — managerial, financial or technical — of these smaller systems can result in less than reliable service for ratepayers.

The policy statement supports the Commission's regionalization efforts, which in recent years has allowed ratepayers of the smaller, troubled systems to experience improved service after being acquired by a larger, more viable water or wastewater system.

Management Audits and Efficiency Investigations

The Commission periodically performs management and operations audits (MAs) or management efficiency investigations (MEIs) of the larger jurisdictional water companies. Among the MAs and MEIs completed within the 2008-09 fiscal year were:

Columbia Water Co.
The MEI was a review and evaluation of the company's efforts to implement

recommendations from the Bureau's June 2005 focused management and operations report. It was found that the company has effectively implemented five of the 12 prior recommendations reviewed and has taken some action on the seven remaining recommendations.

The MEI also resulted in nine additional recommendations for improvement, including efforts to: develop and document a succession plan for the General Manager's position; conduct a study to determine if further reductions in the billing lag could be achieved once substantial implementation of its Automatic Meter Reading system is completed; revise emergency preparedness plans to eliminate deficiencies and strive to keep the plans up to date and site specific; and initiate efforts to comply with the company's goal of operating all of its valves every 18 months.

The York Water Co.

The MA analyzed and evaluated management performance in nine areas. The audit report makes 13 recommendations on issues that have been identified as needing minor or moderate improvement. In response to the audit, The York Water Co. (York Water) submitted an implementation plan indicating acceptance of all 13 recommendations. It was determined that York Water could experience a yearly savings from $63,500 to $87,500 and one-time savings from $211,000 to $375,000 by implementing recommendations contained in the audit.

Some of the areas recommended for further improvement include: developing and adhering to a proactive long-range component to the main replacement program; accelerating the main replacement program to achieve a main replacement rate of approximately 100 to no more than 120 years; adding an education component to the damage prevention program; enhancing efforts to locate and encourage minority, women and persons with disabilities owned business enterprises to submit bids for products and services used by York Water; increasing the inventory turnover level; including current Commission contact information in the Emergency Response Plan; and striving to improve collections performance by using more than one collection agency to identify the best performing agencies.

Pennsylvania American Water Co.

A Stratified Management and Operations Audit conducted by Schumaker & Co. analyzed and evaluated management performance in 20 functional areas and resulted in 114 recommendations for improvement. In its implementation plan submitted to the Commission, Pennsylvania American Water Co. (PAWC) accepted 106 recommendations, partially accepted seven recommendations and rejected one recommendation. It was determined that PAWC could experience yearly savings of up to $1.1 million and one-time savings of up to $400,000 by implementing recommendations contained in the audit report.

The audit recommendations accepted in full or in part include: expediting efforts to develop a long-range Information Technology (IT) plan; enhancing the company's network to enable electronic deployment of software updates to employees; updating the IT Services disaster recovery plan and beginning to routinely review and test disaster recovery plans and document the results; performing an internal audit of the inventory data to determine its accuracy; establishing a central point of management and responsibility for the materials management function at both PAWC and the American Water Works Service Company (AWWSC); analyzing employee turnover at the Pensacola Call Center and developing strategies to reduce turnover; initiating actions to lower the number of over estimates in meter readings; allocating infrastructure improvement budgets on a statewide basis rather than district by district; developing a comprehensive damage prevention program; conducting comprehensive workforce planning for all levels of the organization and providing necessary resources for implementation; assessing PAWC's human resources needs and staff accordingly and increasing accountability to the PAWC President; updating the AWWSC and PAWC affiliate agreement, as necessary,

and submitting it to the Commission for review and approval; and submitting comprehensive diversity reports to the Commission annually.

Statewide Water Resources

The PUC participates in the Statewide Water Resources Committee charged with carrying out Act 220 of 2002. This law requires the development of a statewide plan to manage the Commonwealth's water resources more effectively. Act 220 calls for the 25-year-old state Water Plan to be updated within five years, with regular updates every five years thereafter. The updated plan, issued in March 2009, addresses the quantity of water available in the Commonwealth, the amount used, and the amount needed.

Auditing Emergency Response Planning

The Commission requires that companies certify that their physical and cybersecurity, emergency response and business continuity plans are current. During Fiscal Year 2005-06, the PUC found deficiencies in several of the certified plans that had to be corrected to comply with Commission requirements. In some cases, the plans were outdated, and phone numbers for Commission contacts were obsolete. In March 2006 the Commission initiated an audit program to ensure that all water utilities' emergency response plans are current and in compliance with all applicable laws and regulations, including cyber and physical security along with business continuity. During Fiscal Year 2008-09, emergency response plans were audited for seven of the small water utilities, as well as three of the larger water utilities during the course of routine management audits and management efficiency investigations.

Water and Wastewater System Viability

Pennsylvania has more than 2,200 community drinking water systems, many of which are small water systems serving less than 3,300 consumers. The PUC regulates the rates and service of 193 water and wastewater companies. Many were built decades ago, and a number now face operational, technical and financial challenges that could affect customer service.

Many small water and wastewater systems have varying degrees of operational constraints that impact their viability. Operational constraints inherent to small systems typically include: compliance problems; limited technical and managerial expertise; lack of capital for improvements with a limited ability to borrow at reasonable rates; deferred maintenance;

deteriorated and undersized infrastructure; and minimal sources of supply or storage.

A viable water/wastewater system is one that is self-sustaining and has the financial, managerial and technical capabilities to reliably meet both PUC and DEP requirements on a long-term basis. The most recent Legislative Budget and Finance Committee (LB&FC) performance audit recognized the Commission's work in this area, highlighting efforts to encourage the commitments to enhancing water system viability to ensure that ratepayers of small water/wastewater systems receive the same quality of service provided by larger, viable water/wastewater companies.

Water and Wastewater Plant Inspections

The Commission has conducted 13 plant inspections and one main break inspection through Fiscal Year 2008-09. Random inspections are conducted at various times, usually to inspect companies that have not had any recent inspections. If violations are found, the company is directed to correct the problem. If the problem is not corrected, Commission

staff conducts an informal investigation. The 14 inspections conducted this fiscal year included 12 random, one investigative and one compliance inspection. Six of the random inspections were completed in connection wiht Emergency Preparedness Audit inspections. The investigative inspection was conducted to determine that a main break repair was completed correctly and timely. The compliance inspection, at the invitation of the company, was conducted with the Department of Environmental Protection (DEP) to observe the installation and operation of arsenic treatment facilities that DEP required the company to install.

Regionalization

Many of the water/wastewater mergers and acquisition applications that the Commission acts on are a form of regionalization. In general, regionalization is the consideration of water resources in terms beyond artificial boundaries (townships, boroughs, city limits, municipalities, service territories, etc.). Some water/wastewater systems in Pennsylvania lack the management and funding to stand alone as viable systems. Regionalization typically results in a cost-effective solution or alternative that works to ensure system reliability and water/wastewater standards.

The benefits of regionalization include increased economies of scale and service efficiencies, improved operations, management, and technology. Approaches to regionalization can include mergers, acquisitions, physical interconnections, satellite management agreements and cooperative purchasing/operational pools. Regionalization is not limited to large jurisdictional companies buying or taking over smaller companies. In some cases, nearby non-jurisdictional water companies such as municipalities or authorities also have participated in regionalization efforts.

TRANSPORTATION & SAFETY

Ensuring the provision of safe rail and motor carrier service, the PUC also handles rate filings of transportation companies. The PUC resolves complaints about unsafe conditions at rail crossings and enforces common carrier compliance with safety and insurance requirements.

During Fiscal Year 2008-09, the Commission continued to focus upon passenger carrier safety compliance. The division, as part of its enhanced oversight of the motorcoach industry, performed post-accident motorcoach inspections of compliance reviews. During the year, the division conducted about 12,044 enforcement activities.

The Commission processed applications to approve the construction, alteration and abolition of more than 100 grade crossings. It also completed informal investigations of complaints about unsatisfactory crossing surface conditions, as well as unsafe crossings. The division also conducted more than 25,418 inspections of locomotives, rail cars, tracks and rail operations, as well as 2,595 miles of track.

Motor Carrier Services and Enforcement Division

Motor Coach Program

The Commission has implemented an oversight plan to monitor the safety compliance of Pennsylvania's motor coach operators to ensure the public's protection.

The plan is a four-prong approach to oversee the safety of bus companies operating in the state. First, all new bus carriers must satisfactorily complete a Safety Fitness Review (SFR) within the first 180 days of operation. The SFR is an evaluation of the bus company to determine if the carrier has implemented procedures and other controls to ensure compliance with the PUC's safety regulations. Annual fleet inspections are conducted on all new entrant motor coach carriers and a portion of existing bus companies that hold intrastate operating authority. Carriers with a previous history of safety violations also are subject to the fleet inspections. The Commission conducts driver/vehicle inspections at various sites across the state where there is a high volume of buses transporting passengers, such as at amusement parks and other tourist locations. Finally, the Commission is an active partner with the Federal Motor Carrier Safety Administration's (FMCSA) bus

safety efforts through participation in the Motor Carrier Safety Assistance Program (MCSAP). The Federal Compliance Reviews (CRs) entail a thorough audit of the carrier's safety records and safety management systems to identify violations. A safety rating based on the findings is one result of the CR, and the carrier may be subject to civil prosecution by either or both the FMCSA and PUC. In addition, the PUC works with the FMCSA to investigate carriers lack valid operating authority to operate in interstate commerce. These bus carriers may be utilizing unqualified drivers and vehicles with safety deficiencies while transporting people to and from points in PA.

Unified Carrier Registration (UCR)

The U.S. Unified Carrier Registration System Plan and Agreement (UCR Act) became effective Jan. 1, 2007. In accordance with the UCR Act, motor carriers that operate commercial motor vehicles in interstate commerce must pay a fee based upon the size of the carrier's fleet. For 2009, the fee structure included six brackets, ranging from $39 to $37,500. In addition, individuals and companies that provide freight forwarding, brokering or leasing services in interstate commerce must register their business and pay an annual fee of $39. Motor carriers and the other businesses must register and pay the fee to the state in which they are headquartered.

The PUC has participated in both the 2008 and 2009 UCR Program registration years. Thus far, the PUC has collected $4.3 million for both 2008 and 2009. Although both registration and fee payment deadlines have expired, the PUC continues to pursue and collect delinquent fees.

Household Goods Rulemaking

On Oct. 15, 2008, the proposed rule which amends the definition of "household goods in use" was announced. On April 16, 2009, the final rulemaking was approved by the Commission. The final rule will become final following review

by the Attorney General, the Governor's Budget Office, the legislative standing committees and the Independent Regulatory Review Committee (IRRC), and publication in the PA Bulletin.

The proposed definition excludes from "household goods in use" any household furnishings and effects that are loaded by someone other than the motor carrier onto a trailer or container. In addition, the revised definition of household goods excludes the transportation of property directly from a factory or store when the property was purchased by the householder with the intent to use it in the householder's dwelling. If the rulemaking becomes final, containerized moving services will be regulated as general property, rather than household goods in use.

Operation Safe Student

Commission staff participated in the National Motor Coach "Operation Safe Student" from May 8 to May 21. This enforcement program was designed to conduct inspections focused on motor coach vehicles at destination inspection sites around Pennsylvania. Inspections of buses were conducted at passenger destinations.

During this program, the PUC conducted 312 bus and/or bus driver inspections. Eleven motor coaches and four drivers were placed out of service. The most frequent vehicle out-of-service violation was related to the brake system, while the most frequent driver violation was the failure to have evidence of medical qualification.

Post-Accident Inspections of Buses & Compliance Reviews

As part of its participation in the MCSAP, Pennsylvania has been asked to enhance its oversight of the motor coach industry, following a number of significant crashes that resulted in injuries and fatalities across the state.

The FMCSA Analysis and Information (A&I) website indicates an increase in both injury and fatal crashes for calendar years 2007 and 2008. A&I systems data revealed nine fatal crashes and 699 injury crashes in Pennsylvania during 2007. It was determined that all of the fatal crashes and 357 of the injury crashes involved Pennsylvania domiciled regulated carriers. The remainder involved school bus operations, non-Pennsylvania-based regulated carriers and municipal transit authorities, over which the PUC has no jurisdiction.

As part of an agreement with the Pennsylvania State Police, the Commission's enforcement officers perform post-crash inspections of motor coach vehicles involving fatalities and, in some instances, injuries. The enforcement officers use specially equipped trailers that contain ramps and other equipment to examine buses involved in crashes.

In 2008, enforcement officers conducted 433 motor coach inspections at carrier terminal facilities, resulting in 17 vehicles being placed out of service. In addition, enforcement officers conducted 388 motor coach inspections at 36 remote destination sites that resulted in 24 motor coaches and eight drivers being placed out of service.

In addition to inspection activity, trained enforcement officers conduct compliance reviews on Pennsylvania-domiciled motor coach carriers. A compliance review is an extensive on-site audit of a motor carrier's operations, including equipment and records, to determine a motor carrier's safety fitness. In 2008, seven compliance reviews were conducted, resulting in PUC prosecution against four certificated carriers.

Regulated Motor Carriers

- 5,267 property
- 445 taxis
- 425 limousines
- 453 paratransit
- 75 airport transfer
- 450 group and party
- 58 scheduled route
- 304 household goods movers

2008-09 Enforcement Activities

- 12,044 truck, bus, small passenger vehicle inspections
- 403 informal complaint investigations
- 840 safety fitness reviews

Rail Safety Division

Railroad Safety Improvement Act

On Oct. 16, 2008, the most comprehensive federal rail safety bill in 34 years was signed into law. The Rail Safety Improvement Act of 2008 provides for new regulations and safety studies that will impact some industry operations, as well as the regulatory oversight by government agencies. The Act will develop a long-term strategy for improving rail safety, including an annual plan for reducing the number and rates of rail accidents, injuries and fatalities.

The PUC oversees the safety of railroads in Pennsylvania along with the Federal Railroad Administration (FRA). Safety inspection efforts will be impacted by any changes prompted by the Act. Major provisions of the Act address significant training improvements for railroad workers; implementation of Positive Train Control (PTC) on some railroad operations to establish crash avoidance systems; revisions to hours-of-service rules for railroad crews resulting in additional rest; a requirement of the FRA to issue new regulations for railroads to maintain the safety of their bridges; the establishment of a toll-free telephone number for reporting grade crossing problems; and review of track inspection, maintenance and repair procedures.

Technology and Rail Safety Track Inspections

The PUC conducts its railroad safety efforts in partnership with the FRA pursuant to an agreement in accordance with the Federal Railroad Safety Act of 1970. Safety inspections and investigations of railroad facilities, equipment and records are periodically completed throughout the Commonwealth. The PUC has certified inspectors in the disciplines of track, motor power and equipment, operating practices, and hazardous materials.

Inspectors traditionally use level boards, track gauges and tape measures to check the conditions of the track, looking for rail structural deficiencies and irregular track geometry to reduce the risk of derailments. A new inspection tool that is periodically available is the track geometry car that is part of the FRA's Automated Track Inspection Program (ATIP).

ATIP utilizes state-of-the-art cars with measurement systems that produce a load on the track and accurately records gauge, alignment and track surface, and calculates a safe travel speed for trains. Through the use of advanced electronic sensing and data processing, the vehicle is able to collect track geometry data while traveling at speeds up to 110 mph. After data is compiled on reports which indicate the track deficiencies and locations by GPS, the rail safety track inspectors verify the inspection car results through field examination. The ATIP process has increased the effectiveness and efficiency of the track inspection efforts for both industry and safety regulators.

The geometry cars are frequently scheduled for Pennsylvania main lines because of the high-speed passenger trains, the large number of track miles with heavy tonnage, the high volume of hazardous material shipments, and designation of the Department of Defense Strategic Corridor rail routes.

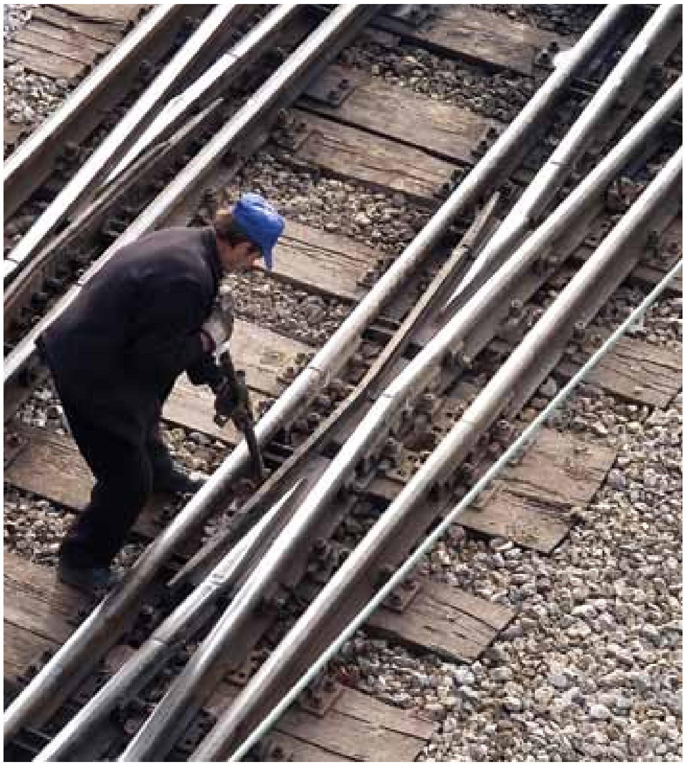
Technology also is available to "X-ray" the rails, looking for internal defects that may eventually fail and potentially cause a derailment. Additionally, some railroads utilize inspection vehicles equipped with ultrasonic and electromagnetic technology instruments. The FRA has established regulations requiring the use of this rail flaw detection technology on certain high-density and passenger lines. PUC inspectors ensure that railroads in Pennsylvania are in compliance with this regulation.

Both the geometry car and the rail flaw detection car have proven to be a tremendous benefit to the rail industry, customers and public safety. With the utilization of ever evolving technology and training, the safety record of rail transportation continues to improve.

Railroad Worker Safety Initiatives

Many occupational hazards exist for railroad roadway workers, so the FRA partnered with labor unions and the railroad industry to create regulations to make the railroad and the worker responsible for safe working practices.

The FRA has issued Roadway Worker Life Tips following an increase in fatalities in 2003. These 14 Life Tips were presented to railroad roadway workers to remind them of the dangers of their jobs. The PUC continues to conduct Life Tip presentations, along with Roadway Worker Protection enforcement during every track inspection. The FRA also initiated a country-wide, four-week "Power Project" to get the Life Tips in the minds of the roadway workers.



The PUC's Rail Safety Division efforts have led to nearly complete compliances in posting Life Tips conspicuously to help remind employees of their responsibilities. This level of compliance is evidence that the PUC rail safety inspectors have delivered a valuable safety message to the workers.

National Gateway Clearance Improvement Project

In May, the PUC participated in a meeting with representatives of CSX Transportation Inc. (CSX) to discuss the "National Gateway Clearance Improvement Project." This project will provide a vertical clearance of 21 feet above the tracks to accommodate intermodal traffic through Pennsylvania via CSX and may potentially reduce the number of trucks on our highways. There are 61 restricted locations in Pennsylvania that will require PUC approval, including: 20 highway bridge structure modifications; seven locations for lowering the track; five modifications of overhead railroad bridges; four modifications of CSX under-grade structures; and 15 tunnel modifications. Pennsylvania is providing $35 million toward the clearance project and is anticipating another $35 million of federal stimulus money.

Operation Lifesaver

Operation Lifesaver is a non-profit, national public education program dedicated to eliminating collisions, deaths and injuries at rail-highway crossings and on railroad rights-of-way. Operation Lifesaver strives to increase public awareness about the danger for motor vehicle operators and pedestrians at rail-highway intersections.

The program seeks to improve driver and pedestrian behavior by encouraging compliance with traffic laws relating to crossing signs and signals. It also points out the dangers on railroad rights-of-way. Designated PUC employees are certified to provide Operation Lifesaver presentations to various groups, such as school children, businesses and civic organizations. Presentations in the past year have been held at elementary schools in the South Middleton School District and the Carlisle School District. The Rail Safety presenters also provide the outreach at events with large public gatherings, such as the Pennsylvania Farm Show.

2008-09 Inspections

- 24,946 railroad car
- 472 locomotive
- 2,595 miles of railroad track
- 576 operating practice

Telephone Directory

CHAIRMAN
Cawley, James H. ---------- (717) 783-1197

VICE CHARIMAN
Christy, Tyrone J. ---------- 783-1763

COMMISSIONER
Pizzingrilli, Kim ---------- 772-0692

COMMISSIONER
Gardner, Wayne E. ---------- 787-1031

COMMISSIONER
Powelson, Robert F. ---------- 787-4301

DIRECTOR OF OPERATIONS
Moury, Karen (Director) ---------- 772-8883

OFFICE OF COMMUNICATIONS
Charles, Tom (Manager of Communications) ---------- 787-9504
Kocher, Jennifer (Press Secretary) ---------- 787-5722

OFFICE OF HUMAN RESOURCES
Hoffman, Kevin (Director of Human Resources) ---------- 787-8714

OFFICE OF ADMINISTRATIVE LAW JUDGE
Smith, Veronica A. (Director & Chief ALJ) ---------- 787-1191

BUREAU OF ADMINISTRATIVE SERVICES
Gramola, Robert C. (Director) ---------- 783-5375

BUREAU OF AUDITS
Lesney, M. Carl (Director) ---------- 772-0311

BUREAU OF CONSERVATION, ECONOMICS & ENERGY PLANNING
Williams, Wayne (Director) ---------- 787-2139

BUREAU OF CONSUMER SERVICES
Vacant (Director) ---------- 783-1661

BUREAU OF FIXED UTILITY SERVICES
Wilson, Robert (Director) ---------- 783-5242

LAW BUREAU
Pankiw, Bohdan R. (Director & Chief Counsel) ---------- 787-5000

LEGISLATIVE AFFAIRS
Perry, June (Director) ---------- 787-3256

SECRETARY'S BUREAU
McNulty, James J. (Secretary) ---------- 772-7777

OFFICE OF SPECIAL ASSISTANTS
Davis, Cheryl Walker (Director) ---------- 787-1827

BUREAU OF TRANSPORTATION
Hoffman, Michael (Director) ---------- 783-3846

OFFICE OF TRIAL STAFF
Simms, Johnnie (Director) ---------- 787-4886

PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265
HARRISBURG, PA 17105
1.800.692.7380
www.puc.state.pa.us