COMMONWEALTH OF PENNSYLVANIA

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February 10, 1998

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Office of the Prothonotary
Pa. Public Utility Commission
North Office Building
P. O. Box 3265
Harrisburg, PA 17105

**Re: Application of Duquesne Light Company
for Approval of its Restructuring Plan
Under Section 2806 of the Public Utility Code
Docket No. R-00974104**

Dear Prothonotary:

Enclosed for filing are the original and nine (9) copies of the Main Brief on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Angela T. Jones
Assistant Small Business Advocate

Enclosures
cc: Hon. John H. Corbett, Jr.
Administrative Law Judge

Parties of Record

Mr. Brian Kalcic

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company For Approval Of Its Restructuring Plan Under Section 2806 Of The Public Utility Code	:	Docket No. R-00974104

ORIGINAL

MAIN BRIEF
OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

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Dated: February 10, 1998

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

A. Introduction

On August 1, 1997, Duquesne Light Company ("Duquesne" or "Company") filed its Restructuring Plan pursuant to the Electricity Generation Customer Choice and Competition Act, 66 Pa.C.S. §§2801-2813. As modified during this proceeding, Duquesne's Restructuring Plan proposes to utilize actual market-based price information through a request for proposal ("RFP") or bidding system to establish customer generation credits ("CGCs"). Relying on Section 2804(4)(v) of the Competition Act, the Company proposes to collect the maximum amount of competitive transition charge ("CTC") revenue as possible in each of the transition periods. The final market-based determination of Duquesne's stranded costs would be in 2003.

To determine the market value of its generation assets, the Company proposes an asset divestiture at the Commission's option in 2003. If the divestiture option is not elected, an arbitration panel would determine the final market valuation.

The Company proposes to amortize and/or depreciate at least $1.7 billion of generation-related assets over the transition period. The Company proposes to set the CTC and the CGC annually, based upon results of the sale of firm power from its generation capacity. Once the market-based CGC is determined, Duquesne would set the CTC as the residual amount allowed under its current rate cap. If the Company's earnings during the transition period are better than expected, a return-on-equity ("ROE") spillover mechanism is proposed to ensure that such earnings are used to mitigate stranded costs. The earning based ROE level would be 11.5%.

The Company will proceed with an early determination of the final market-based value of the Company's plants if either of two triggers occur. The first trigger is an increase in long-term market price of power to a level of $24.9/MWh

in 2001 and $25.6/MWh in 2002. The second trigger relates to the ROE spillover mechanism. If the Company's earnings should exceed 11.5% during the transition period, Duquesne would establish a deferred revenue account credit which would be used to fund accelerated depreciation and amortization. Should the Company's earnings fall below 11.5%, the deferred revenue account would be adjusted to increase the Company's earnings to 11.5% or eliminate the balance in the account, whichever is smaller.

From the Company's cost-of-service study for the calendar year ending December 31, 1996, Duquesne identifies the transmission and distribution ("T&D") components embedded in current rates for each rate class. The T&D component is subtracted from current rates to arrive at a maximum generation component for use later by rate class. The CGC is determined for each rate class by adjusting the system average market rate for differences in class consumption patterns, losses and gross receipts tax. Finally, the CTC component is determined by class, by subtracting the CGC of each class from its respective generation rate cap.

The Office of Small Business Advocate ("OSBA") filed a Notice of Intervention on September 4, 1997 and actively participated in this proceeding. In accordance with the procedural schedule, the OSBA submitted the Direct Testimony, Rebuttal Testimony, Surrebuttal Testimony and Exhibits of Mr. Brian Kalcic. Pursuant to a stipulation among the parties, the pre-filed testimony along with OSBA Cross Examination Exhibits Nos. 1 and 2 were admitted into the record on January 9, and January 15, 1998, respectively.

By this Main Brief, the OSBA does not recommend an overall level of stranded costs to be recovered by Duquesne. Rather, this Main Brief sets forth the OSBA's primary concerns regarding the propriety of the specific recovery mechanism by which Duquesne proposes to recover stranded costs from its small business customers. Further, by this Main Brief, the OSBA addresses several other aspects of Duquesne's Restructuring Plan that significantly impact the

small business community, proposing that certain safeguards be implemented to ensure that Duquesne's small business consumers are treated fairly during the transition to a competitive generation environment.

B. Overview of the Act

By Act 138 of 1996, known as the Electricity Generation Customer Choice and Competition Act ("Competition Act"), the Pennsylvania General Assembly added Chapter 28 to the Public Utility Code. 66 Pa.C.S. §§2801-2813. In promulgating this legislation, the General Assembly declared that "[t]his Commonwealth must begin the transition from regulation to greater competition in the electricity generation market to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs." 66 Pa.C.S. §2802(7). The legislature also stressed the importance of resolving the many transitional issues in a manner that is "fair to customers, electric utilities, investors, employees of electric utilities, local communities, nonutility generators of electricity and other affected parties." 66 Pa.C.S. §2802(7) and (8).

Through this amendment to the Public Utility Code, the legislature established some basic standards and procedures designed to provide for direct access by retail customers to the competitive market for the generation of electricity, while maintaining the safety and reliability of the electric system for all parties. In particular, the Competition Act requires "electric utilities to unbundle their rates and services and to provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth." 66 Pa.C.S. §2802(14). As to the resolution of many of the specific issues required to fully implement the directives of the Competition Act, the legislature delegated extensive responsibility to the Commission. See, e.g., 66 Pa.C.S. §§2804, 2806 and 2808.

Recognizing that electric utilities have incurred certain costs as a result of long-term investments in generation facilities and long-term power supply agreements which "may not be recoverable in a competitive market," the legislature empowered the Commission "to determine the level of transition or stranded costs for each electric utility and to provide a mechanism...for the recovery of an appropriate amount of such costs in accordance with the standards established" in Chapter 28. 66 Pa.C.S. §2802(15) (Emphasis added). "[T]ransition or stranded costs" are defined as an "electric utility's known and measurable net electric generation-related costs...which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which...will remain following mitigation by the electric utility." 66 Pa.C.S. §2803 (Definitions).

The extent to which the Commission may authorize the recovery of stranded costs by electric utilities is specifically limited by the Competition Act to those costs that are determined to be just and reasonable. 66 Pa.C.S. §2804(13)-(14); 66 Pa.C.S. §2808(c); 66 Pa.C.S. §2812(a)(2)(iii). In particular, Section 2808(c) expressly imposes an obligation upon the Commission to determine what level of an electric utility's stranded cost claim attributable to generation plants may appropriately be recovered. 66 Pa.C.S. §2808(c)(1)-(3). Also, this provision of the Competition Act requires the Commission to "consider the extent to which the electric utility has undertaken efforts to mitigate" its stranded costs, as well as any measures employed by the electric utility to reduce or moderate customer rate levels prior to the enactment of the Competition Act. 66 Pa.C.S. §2808(c)(4)-(5). In establishing the general parameters for the non-bypassable stranded cost recovery mechanism referred to as the CTC, Section 2808(a) of the Act provides that electric utilities will be afforded an opportunity to recover their transition or stranded costs, so long as the recovery of those costs is accomplished in a manner that "maintains consistency

with the allocation methodology for utility production plant accepted by the commission in the electric utility's most recent base rate proceeding" and does not "shift inter-class or intra-class costs." 66 Pa.C.S. §2808(a). As to the time period over which electric utilities may collect the CTC from their T&D customers, Section 2808(b) authorizes such recovery through December 31, 2005, nine years after the effective date of the Competition Act. 66 Pa.C.S. §2808(b).

During the period while electric utilities are recovering stranded costs through the imposition of a CTC, ratepayers enjoy certain protections under the Competition Act. Specifically, if an electric distribution utility is either still collecting a CTC or some of its customers still lack direct access, it may not increase its T&D charges for any of its customers, whether they purchase generation from the electric distribution utility or an alternative generation supplier, prior to June 30, 2001, fifty-four months after the effective date of the Act. 66 Pa.C.S. §2804(4)(I). Further, as long as an electric distribution utility is recovering stranded costs through a CTC or some of its customers are ineligible for direct access, it is precluded from increasing the generation rates above 1996 levels for any of its customers who continue to purchase generation from the utility prior to December 31, 2005, nine years after the effective date of the Act. 66 Pa.C.S. §2804(4)(ii).

A final provision of the Act that is particularly important to small business customers is Section 2806, which provides for the implementation of direct access through a three-year phase-in period beginning on January 1, 1999. Under this section, one-third of the peak load of each customer class must have the opportunity for direct access as of January 1, 1999, while two-thirds of the peak load is eligible for direct access by January 1, 2000. All customers of electric distribution companies must have direct access to a competitive generation supply by January 1, 2001. 66 Pa.C.S. §2806(b).

C. Summary of Argument

The OSBA addresses six (6) issues concerning the Company's proposed restructuring plan. These issues are: (1) method of customer selection in the phase-in of customer choice; (2) timetable of phase-in for customer choice; (3) basis of unbundling cost of service for T&D; (4) length of stranded cost recovery period and determination of class responsibility for stranded costs; (5) Duquesne's rate redesign plan; and (6) class allocation of universal service costs. The OSBA asserts that these issues in Duquesne's proposed restructuring plan are critical to the reasonable and equitable treatment of the small business class in a direct retail access market.

The OSBA endorses the revised proposal of Duquesne concerning the assignment of distribution line losses to the generation function. The OSBA agrees with Duquesne's proposed provision of either a fixed/variable CTC or an all-variable CTC at the customer's option. The OSBA also accepts Duquesne's phase-in methodology for the small business class which would select customers on the basis of randomly selected zip codes. However, the OSBA adds a caveat to its acceptance of this proposal, that being, the dispute resolution process for claims of competitive disadvantage should be included in the Company's consumer education plan. Furthermore, the OSBA recognizes the Commission precedent to accelerate the timetable of the phase-in to customer choice as applicable to this proceeding. The OSBA agrees that this accelerated phase-in approach to customer choice addresses the mandates of the Competition Act and minimizes potential competitive disadvantage problems.

The OSBA does not agree with the Company's proposed basis for determining its functionalized distribution revenue requirement. The treatment asserted by the Company is inconsistent with Commission precedent and violates the Competition Act. The OSBA recommends that the Company comply with the

Commission's interpretation of the Competition Act by amending its filing to reflect a realized rate of return in the distribution revenue requirement.

The OSBA endorses a CTC allocation approach for determining a class' responsibility for stranded costs. OSBA also suggests that, to give meaningful customer choice, the stranded cost recovery period should not be accelerated. An extension of the stranded cost recovery period would provide Duquesne an opportunity to recover from each class its proper share of generation-related stranded costs.

The OSBA also expresses its concerns regarding a possible determination of a first-come first-served ("FCFS") method of implementing customer choice during the phase-in period of direct retail access. The OSBA foresees that this method, if selected, would result in discriminatory treatment of the small business customer class. The OSBA recommends a modification to the FCFS method that would serve to bar discrimination to small business customers. The implementation of the FCFS method as advocated by the OSBA would result in compliance with the Competition Act.

The OSBA proposes that no class should receive less than a cost-based allocation of universal service charges. To be in compliance with the Competition Act, OSBA recommends that Duquesne's universal service costs be allocated consistent with the rate treatments found in the Company's most recent rate case.

II. Phase-In of Customer Choice

A. Method of Customer Selection

The Competition Act suggests that customers be selected on a FCFS basis to attain direct access during the first two years of the transition period. 66 Pa.C.S. 2806(4). However, the Competition Act does afford the Commission the discretion to choose a different approach. In particular, this provision

recognizes the need to examine other phase-in methods so as "to prevent competitive disadvantages among similarly situated customers within a customer class." 66 Pa.C.S. §2806(b)(4).

The Company proposes a different phase-in plan from the FCFS customer selection methodology suggested in the Competition Act. 66 Pa.C.S. §2806(4). The Company proposes to phase-in direct retail access in three equal increments of one-third of the peak load of each customer class annually starting January 1, 1999, so that all customers would be eligible for direct retail access by January 1, 2001. Duquesne Statement No. 6 at 3. Residential and small commercial customers would be randomly selected by zip code-based geographic areas of choice ("GACs") under the proposed plan. Id. The rationale behind this approach is to allow residential and small commercial customers in the same neighborhood to be phased-in together. Also, the Company asserts that this approach "ensures non-discriminatory eligibility, instead of eligibility driven by which customers are better informed or respond more quickly to an open enrollment process." Id.

Other commercial and all industrial customers will be selected by their SIC code-based market segments under the plan. Id at 4. The Company proposes to prioritize the release of these market segments based on the results of its pilot program open enrollment process. Those market segments having the largest percentage of total accounts nominated by customers for participation in the pilot program will be included in the first phase until the one-third peak load limit is reached or exceeded. This system of prioritization will be followed to achieve the two-third peak load limit for the second phase as well. The reason for this method of selection for the phase-in of direct retail access is to "allow customers that compete with each other to be phased-in together, thus eliminating many disputes about competitive disadvantage." Id. The Company has

also proposed a specific complaint resolution process to resolve any competitive advantage dispute that may arise. Id.

The Company considered but rejected a FCFS approach as a phase-in methodology, asserting that this process "is only equitable if one presumes all customers are equally informed and educated about both the benefits of competitively priced generation and the procedural aspects for enrolling in the program." Duquesne Statement No. 6-R at 7 (Emphasis in original). The Company also considered another method of customer selection which would have required all customers to participate at only one-third of their load, but rejected this approach as "presenting excessive difficulties in account administration and billing...imposing unnecessary complexity and inconvenience [to] customers." Duquesne Statement No. 6 at 5.

The OSBA can accept the Company's proposed phase-in methodology with certain clarifications. First, the Company indicated that it would favorably treat a complainant within the dispute resolution process if customers could show "a) their business has been misclassified or b) other businesses with the same product or service have received a competitive advantage." OSBA Statement No. 1 at 16. The public, however, must be adequately informed of the dispute resolution process and the potential benefits it affords them. Consequently, the OSBA recommends that if the Company's plan for the phase-in to competition is approved, the Company should be ordered to include an explanation of the dispute resolution process in the Company's consumer education plan.

Second, the OSBA seeks to ensure that Duquesne's phase-in plan permits small business customers to be fairly represented in the first two steps of the phase-in. "[A]s long as smaller (non-SIC code) customers are phased-in up to the limits of their own peak load levels and all customers within a given SIC code are made eligible at the same time," the OSBA can assert that Duquesne's phase-in

plan will treat small business customers fairly. Id at 17. These clarifications were confirmed by the Company through interrogatory responses. Id.

Several intervenors, however, have rejected the Company's proposed customer selection methodology for phase-in to direct retail access in favor of a FCFS selection process. See, DII Statement No. 1 at 60 (recommendation is for the industrial customer class only), OCA Statement No. 5 at 57 (recommendation is for the residential customer class only), Enron Statement No. 4 at 20 (recommendation for FCFS is for residential and small commercial customer classes only), and MAPSA Statement No. 1 at 62. Pennsylvania Retailers Association ("PRA") proposes to allow all customers within a customer class an opportunity to receive direct retail access for one-third of their load, progressively for each of the years during the phase-in. PRA Statement No. 1 at 6 (specific to large commercial customers).

Company witness Mr. Frank Hoffmann conceded that the Company "is not completely rejecting [FCFS, the Company] is just suggesting that the approach that [it] is proposing is superior to [FCFS]." Tr. 1049. As discussed below, OSBA has specific concerns if the Commission were to adopt a FCFS phase-in approach.

Mr. Kalcic has testified that a FCFS approach would likely result in an under-representation of small business customers in the first two steps of the phase-in. OSBA Statement No. 1R at 12. The Company's small business customers are served via Rate GS/GM which is available to all non-residential customers whose billing demands do not exceed 300 kW. Mr. Kalcic testified that Rate GS/GM is not homogeneous in nature, but rather contains customers with inherently diverse billing demands, usage patterns and physical size. Id at 12-13.

Mr. Kalcic also pointed out that the larger a customer's electric bill, the greater the potential savings associated with direct access. Id at 13. Obviously then, the greater the potential savings that may be obtained, the more of a priority direct retail access becomes for a customer. Thus, there is a greater

incentive to obtain, evaluate, and process information concerning direct retail access in a timely fashion for larger electric consuming customers than for smaller customers. It would also follow that larger volume customers would respond more promptly to a FCFS phase-in program.

Given the wide diversity that exists within the Company's Rate GS/GM class, one could anticipate that the high end, large account customer within the GS/GM class would be over-represented in the first two steps of the phase-in under the FCFS system. In contrast, however, the small account customers would be under-represented under this same system. Id.

The Competition Act prohibits the Commission from adopting a restructuring plan that unreasonably discriminates against one customer class to the benefit of another. 66 Pa.C.S. §2804(7). For the aforementioned reasons, a straight FCFS phase-in could result in discrimination against the interests of Duquesne's small commercial customers. The OSBA recommends, should an FCFS procedure be adopted, that the Rate GS/GM class group be segmented into "Small Rate GS/GM" and "Large Rate GS/GM." OSBA Statement No. 1R at 14. The segment limitation for the Small Rate GS/GM was suggested at a 40 kilowatt load; however, a different breakpoint could be determined by the Company from a detailed bill frequency analysis of all Rate GS/GM accounts. Id. OSBA recommends that the Company, based on its load research, designate progressively, one-third of the peak load of the Small Rate GS/GM segment over the phase-in period and the same for the Large Rate GS/GM segment with the total of the segmented load levels eligible for a given year equal to that allowed for Rate GS/GM as a whole. Id at 15. This segmentation process working within a FCFS phase-in methodology would simply provide small business customers the same level of opportunity for direct retail access that would otherwise be forthcoming from within a more homogeneous rate schedule. Id.

Lastly, it is reasonable to provide this comparable treatment to the small business customer class since the legislature has provided separate

representation for this class by the enactment of the Small Business Advocate Act, 73 P.S. §399.41 et seq. Additionally, the Commission has traditionally provided similar segmentation to the small business customer class from the business class at-large in recognition of the problem of homogeneity. See, In Re: Bell Atlantic Pennsylvania Inc. Petition and Plan for Alternative For of Regulation Under Chapter 30, et al., Docket No. P-00930715 et al., (Order entered June 28, 1994) at 178 (stating that only small businesses receive the same protections in local service as residential customers with respect to increases under the price stability mechanism). This comparable procedure was utilized when transitioning from a regulated environment to an unregulated environment in the telecommunications industry.

B. Timetable for Phase-In

The OSBA notes that the Commission directed an accelerated phase-in of customer choice in Application of PECO Energy for Approval of its Restructuring Plan under Section 2806 of the Public Utility Code, et al., Docket Nos. R-00973953, P-00971265 (Order entered December 23, 1997) at 47-49 ("PECO Restrucuting Order"). Under that Order, customer choice up to 33% of all customer classes will be eligible to shop on January 1, 1999 and another 33% become eligible to do so the next day. By January 2, 2000 all PECO customers will be able to shop for electric generation service. This more rapid phase-in of customer choice effectively makes the potential for competitive disadvantages to small business customers a one year rather than a two year problem. OSBA agrees that accelerating the phase-in to customer choice in this manner is a way to address the statutory mandates of Section 2806(b) of the Competition Act and to minimize potential competitive problems of small business customers. 66 Pa.C.S. §2806(b).

III. Transmission and Distribution Rates; Unbundling Issues

A. Introduction

The Competition Act addresses the deregulation of the generation component of electric service while the T&D services remain regulated and consequently have tariffed rates. Specifically, as a declaration of policy, the Competition Act calls for resolution of transitional issues in a fair and equitable manner for all affected parties when moving toward a competitive generation market. 66 Pa.C.S. §2802(8). Moreover, as a means to obtain a competitive generation market, the Competition Act requires the unbundling of electric utility "rates and services...to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth." 66 Pa.C.S. §2802(14).

The Company must propose rates for T&D services in accordance with the Competition Act. Prior to the enactment of the Competition Act, the utility's overall rate of return involved all three components of service, i.e. generation, transmission, and distribution. By statutory mandate, the Company must now unbundle its existing rates, such that these tariffed rates reflect the regulated services of T&D. 66 Pa.C.S. §2804(4).

There are, however, instances where it may not be clear whether service is to be functionalized as a generation service or a transmission or distribution service. A controlling factor in the functionalization is whether the Company would see a comparable service offered in the competitive market as part of an arsenal of services supplied by alternative suppliers of generation. If this were the case, the service should be allocated as a generation service and thus receive unregulated treatment. Otherwise, the Company would fix a rate and rely on a particular return because the service would be akin to T&D.

This functionalization process is crucial to upholding the policy that, "electric service should be available to all customers on reasonable terms and conditions." 66 Pa.C.S. §2802(9). Improper functionalization could result in

the Company receiving a known rate of return on service that is available in the competitive marketplace. Where competition has driven down the margin of profit or provides a lower profit margin than that achieved under regulation, improper functionalization could produce an uneven playing field with the regulated entity offering a competitive service at a greater than market price. This result could provide a decisive advantage to the regulated utility, be anticompetitive, and contravene the provisions of the Competition Act. 66 Pa.C.S. §§2802(8) and 2811(a).

B. 1996 Test Year Cost of Service

The OSBA does not oppose the Company's proposal to utilize 1996 as the test year for cost of service.

C. Required v. Realized Rates of Return

Section 2804(4) of the Competition Act states that for parties who choose an alternative supplier, the total charges for non-generation services shall not exceed the non-generation charges that were applicable as of the enactment date of the Act. 66 Pa.C.S. §2804(4)(I)(B). These charges, consequently, are capped at the rate that the Commission approved in the Company's last rate case. These capped rates apply to the utility's total non-generation charges through June 30, 2001.[1] The Company's overall return on rate base provided at current approved rates is 8.86%. Duquesne Statement No. 5-R at 35. The Company prepared its unbundled cost of service study on the basis of its estimated required cost of capital. Duquesne Statement No. 5-R at 35. That required cost of capital percentage rate is 9.61%, which produced revenue requirements in excess of its test year revenues.[2] Id.

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[1] 54 months following the effective date of the Competition Act.

[2] Duquesne adjusted its overall generation rate cap in order to keep its total revenue requirement at the test year level.

Accordingly, under the Company's unbundled rates as proposed, any customer who purchases generation from an alternative supplier would be charged an unbundled distribution rate that would exceed the charge previously approved by the Commission. This result necessarily is in violation of Section 2804 of the Competition Act. 66 Pa.C.S. §2804(4)(I)(B). Moreover, a public utility cannot implement a rate different from that specified by its tariff for the corresponding service rendered. 66 Pa.C.S. §1303. Thus, to provide service at the estimated cost levels advocated by the Company would violate Section 1303 of the Public Utility Code as well.

Additionally, the Company's witness, Mr. James Lahtinen testified that he was familiar with the restructuring filings of PECO Energy Company, Pennsylvania Power & Light Company, and UGI Utilities Inc. Tr.711. The witness assumed that these aforementioned electric utilities used realized rate of return and not Company claimed rate of return to develop unbundled rates. Tr. 712-13. Certainly, such treatment could be viewed as suggestive of an industry standard. Moreover, Mr. Lahtinen agreed that Commissioner Hanger's Motion[3] approved realized rate of return for distribution rates as proposed by PECO in its application. Tr. 717. (Emphasis added).

The OSBA recommends that the Company use its functionalized revenue requirements that reflect class and system average rates of return provided by current revenues at the rate cap, i.e. 8.86% on average. This action would be consistent with the precedent set by the PECO Restructuring Order and comply with the Competition Act.

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[3] Application of PECO Energy for Approval of its Restructuring Plan under Section 2806 of the Public Utility Code, et al., Docket Nos. R-00973953, P-00971265 (Order adopted December 11, 1997) at 24. This document was referenced at the time of the hearing on December 17, 1997. The Commission had not at that time issued an Order consistent with this Motion.

D. Distribution Losses

First an explanation of the distribution loss phenomenon is in order. The electric energy produced by the generation supplier must be transmitted to the locality of the consumer as well as conditioned to the correct voltage at which the consumer can receive it for use on demand. However, some of the energy generated dissipates or is lost through the transmission and distribution process. The energy lost between the generation/transmission process and the actual use of this energy by the consumer is the distribution loss.

Contrary to the Company's initial filing, Duquesne is now proposing that distribution losses be assigned to the generation function. Duquesne Statement No. 5-R at 3-4 and 22. OSBA agrees. The Company has agreed that distribution losses can be procured competitively by any alternative generation supplier. Duquesne Statement No. 5-R at 22. Several intervenors support this notion that distribution losses can be supplied competitively. See, OSBA Statement No. 1 at 9, Enron Statement No. 2 at 11, and OCA Statement No. 4 at 6. Since distribution losses can be supplied in the competitive generation market, there is no reason to deny customers an opportunity to benefit from competition for this service. OSBA Statement No. 1 at 9.

To the contrary, the continued regulation of a service that can be competitively supplied would result in an unlevel playing field, a decisive advantage to the regulated entity, and anticompetitive behavior. The Competition Act requires the Commission to "resolve certain transitional issues in a manner that is fair to...[all] affected parties," and directs the Commission to "take steps...to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power." 66 Pa.C.S. §§2802(8) and 2811(a) respectively. Any application of the restructuring plan of the Company that would result in anticompetitive behavior by the Company would violate those statutory mandates. Therefore, OSBA recommends that the Commission affirm the

Company's rebuttal testimony proposals for the treatment of distribution losses as generation-related and assign them accordingly.

IV. Transition or Stranded Costs

V. The Competitive Transition Charge

A. Conceptual Disputes Regarding Calculation of CTC/CGC

1. Differences in Overall Approach

2. Other Conceptual Disputes

(a) CGC Calculation: Annual Adjustments v. Fixed Schedule
(b) Determination of Class Responsibility for Stranded Costs

The witness of the Duquesne Industrial Intervenors ("DII"), Mr. Stephen Baron, proposed that the CTC component of Duquesne's unbundled rates be determined as a residual after subtracting the unbundled transmission, distribution and estimated market generation components from the current bundled rates. DII Statement No. 1 at 30. Mr. Baron asserted that since the CTC is calculated as a residual, there is no need to levelize and/or allocate the stranded cost revenue requirement to rate classes over the full transition period. DII Statement No. 1 at 11. Instead, Mr. Baron argued that maximum CTC revenues should be collected, as available, from all rate classes to effectively amortize Duquesne's stranded cost balance as quickly as possible. OSBA Statement No. 1R at 3. The OSBA does not agree.

Mr. Kalcic asserts two reasons why early termination of the CTC recovery period would not be appropriate even where it is otherwise possible: (1) an extension of the CTC recovery period allows stranded costs to be allocated to rate classes -- resulting in a more equitable assignment of stranded cost responsibility to rate classes than would be the case in the event of an earlier termination, and (2) an extension of the time period for stranded cost recovery could provide all ratepayers with an immediate (1999) rate reduction, independent

of their eligibility in the phase-in process; a reduction which would not be available under an "accelerated" amortization proposal such as DII's. Id at 4. OSBA is not alone in this proceeding in advocating that market-based CGCs be combined with an allocation of the CTC revenue requirement to rate class. The Office of Consumer Advocate ("OCA") witness, Ms. Lee Smith, also recommended this approach. OCA Statement No. 4 at 9-10.

In the DII proposal all classes would pay CTC charges equal to the full difference between their existing generation rate cap and the market generation component rates. In essence, classes with more "space" under their existing generation rate cap would pay CTCs for those classes that had less space, until Duquesne recovered its total stranded costs. OSBA Statement No. 1R at 5 (Emphasis in original). This method is inappropriate since the available margin that a class exhibits under the generation rate cap is a function of its current rates. Id. Those classes which implicitly pay larger "premiums" for generation should receive greater benefits from direct retail access. Id. This follows from the premise that competition will eliminate all generation premiums paid by ratepayers. If, however, generation premiums are used to amortize Duquesne's stranded costs as quickly as possible (as is the case in the DII proposal), an interclass shift of CTC cost responsibility from low premium to high premium classes would result, effectively denying the latter classes their proportionate share of benefits during the period of stranded cost recovery. Id at 5-6. This result violates the statutory mandate against interclass and intraclass cost shifting in Section 2808(a) of the Competition Act. 66 Pa.C.S. §2808(a).

The inequity of denying high premium classes their proportionate share of benefits during the stranded cost recovery period can be mitigated by extending the collection of the CTCs over a longer portion of the statutory seven year period. Id at 6. The extension of the stranded cost recovery period would provide the opportunity to equitably allocate stranded cost to rate classes in proportion

to each class' current share of Duquesne's production-related capacity costs. Id. It would also provide each class with a generation credit that would allow meaningful customer choice. Id.

Moreover, an extension of the recovery period would not require the full residual under the generation rate cap to be used for the CTCs. Id (Emphasis in original). This "unused" residual becomes the aforementioned immediate rate reduction, and the second reason not to accelerate the stranded cost recovery period. Id.

Finally, the OSBA observes that in the recent PECO Restructuring Order, the Commission did not adopt an accelerated stranded cost amortization period as advocated by DII witness Baron in this proceeding. Rather, the Commission adopted a plan which allocated stranded costs to rate classes with those costs to be recovered over an 8½ year period. PECO Restructuring Order, at 109-110. Accordingly, to be consistent with the Commission precedent established in the PECO Restructuring Order, and for the aforementioned policy reasons, OSBA recommends that the DII accelerated amortization proposal should be rejected.

(c) Levelized CTC v. Other Methods
(d) Duquesne's Rate Redesign Proposal

Through the Company's rate redesign plan, Duquesne proposes to reduce current rate levels over 25% on average for consumption above 1996 levels. Duquesne Statement No. 5 at 31. This proposed rate reduction on incremental usage has a dual purpose: (1) to provide more efficient price signals, and (2) to encourage economic load growth. Id.

The CTC forms the cornerstone of the Company's rate redesign. As originally filed, the Company proposed to split its CTC charge into two components: (1) a variable usage charge, and (2) a customer-specific fixed charge.[4] The variable

[4] As discussed below, Duquesne later modified its rate redesign plan to give the customer the option of an all variable CTC.

CTC charge would be set at a level which would significantly lower the current total charge associated with energy usage. Id. The resulting discount that would be associated with a customer's baseline consumption would be recouped in the form of a customer-specific fixed CTC charge. If a customer's usage level post-restructuring is unchanged from those established in 1996 (the Company's baseline year), the customer would experience the same total bill after unbundling.

On the other hand, the Company's initially proposed fixed CTC charge would result in larger bills for any customers with baseline consumption levels that were higher than normal. For example, a higher than normal baseline consumption could be expected if a consumer upgraded to more energy efficient appliances post-1996.. OSBA Statement No. 1 at 13. Additionally, the same would hold for a consumer who elected to weatherize his or her home with more efficient windows, caulking, and insulation post-1996. Moreover, as Mr. Kalcic stated, a business customer who experienced an exceptional sales year in 1996 might also exhibit an "inflated" baseline usage level. Id. (Emphasis in original). In all of the aforementioned scenarios, the customer would be worse off due to the Company's rate redesign.

The Competition Act at Section 2808(a) states that stranded costs should not be recovered from customer classes in a manner that causes either inter-class or intra-class cost shifts. 66 Pa.C.S. §2808(a). The Company's plan, as initially proposed, violated Section 2808(a) of the Competition Act.

Recognizing the above, the OSBA advocated an amendment to the Company's original plan whereby a customer could select an all-variable CTC or a fixed/variable CTC dependent upon which plan would best suits the customer's needs and anticipated consumption. OSBA Statement No. 1 at 14. OSBA asserted that providing a customer option within the rate redesign plan would afford it an opportunity to produce the elasticity-related benefits that the Company attributed to its plan while eliminating its inherent inequities. Id.

The Company adopted the amendment proposed by OSBA, noting that this change causes its rate redesign plan to be more reasonable with respect to the customer's interests. Duquesne Statement No. 5-R at 45. We agree.

VI. Rate of Return/Discount Rate

VII. Special Customer Classes

VIII. Competitive Safeguards

IX. Duty to Serve

X. Universal Service and Energy Conservation

A. Introduction

The Company filed its restructuring plan with the Commission on August 1, 1997. This plan, as filed, omitted a mechanism to recover the Company's universal service and energy conservation costs over the life of these programs. Such a design is statutorily required as part of the standards in restructuring the Company in order to complete the transition to a competitive generation market. See, 66 Pa.C.S. §2804(15). The universal service and energy conservation programs have associated public purpose costs which have been included in bundled rates of the utilities. The public purpose is to continue to be promoted through "universal service and energy conservation policies, protections and service and full recovery of such costs is to be permitted through a nonbypassable rate mechanism." 66 Pa.C.S. §2802(17).

The Company cured this defect in its restructuring filing by submitting a detailed plan for recovery of universal service and energy conservation costs on November 3, 1997. The universal service and energy conservation plan was submitted in response to an interrogatory sponsored by the OCA. The plan contained (1) a description of the applicable legislative and regulatory requirements, (2) an overview of the Company's universal service and energy conservation goals and methods to achieve these goals, (3) an itemized showing

of the Company's existing policies, protections, and services, (4) the Company's response to requirements necessary for the unbundling of service elements to enter a competitive market, (5) an assessment of universal service needs, (6) a review of current expenditures, (7) a proposal for universal service and energy conservation programs operations, and cost recovery proposals, and (8) proposals on evaluation, reporting, and advisory panels.

The functionality of the programs as they aid low income families and the criteria of the applicant to satisfy need, while clearly necessary for the operation of the plan, will not be addressed by the OSBA. The cost recovery procedure utilized to fund the plan, however, is a pertinent issue for OSBA. The statute conspicuously gave deference to the Commission in establishing appropriate cost recovery mechanisms concerning the funding of the universal service and energy conservation plans of utilities. See 66 Pa.C.S. §2804(8).

The Commission has already provided guidelines for utilities to follow in constructing their universal service and energy conservation plans. Final Order Re: Guidelines for Universal Service and Energy Conservation Programs Made Pursuant to 66 Pa. C.S. §§2803, 2802(17), 2804(8) and 2804(9), Docket No. M-00960890F0010 (Order entered July 11, 1997)("Universal Service Order"). The OSBA recommendations discussed below serve to build compliance with the Universal Service Order and to implement the "restructuring of the electric utility...in a manner that does not unreasonably discriminate against one customer class to the benefit of another." 66 Pa.C.S. §2804(7).

B. Overall Funding and Rate Issues

1. Eligibility and Funding Levels

2. Cost Allocation and Rate Design

The statute mandates that restructuring should be implemented in a manner that does not unreasonably discriminate against one customer class to the benefit of another. 66 Pa.C.S. §2804(7). Mr. Kalcic testified that to comply with

Section 2804(7) of the Competition Act and the Commission's Universal Service Order, the Company's universal service charge ("USC") should be developed in a manner that is consistent with the Company's most recent rate case treatments. To do otherwise would shift costs among Duquesne's rate classes, in violation of the Competition Act prohibition against interclass and intraclass cost shifting. OSBA Statement No. 1R at 10-11. The Commission has previously recognized that Section 2804(7) is a prohibition against interclass and intraclass cost shifting when it stated just that in its Universal Service Order, discussing cost recovery of universal service and energy conservation programs. Universal Service Order, Docket No. M-00960890F0010, (Order entered July 11, 1997) at 20 Section G; see also, PECO Restructuring Order at 53 (noting its interpretation of Section 2804(7)).

Mr. Flynn testified that the Company's preferred method for collecting the universal service costs is on a per kilowatt hour basis. Duquesne Statement No. 14-R at 25, Tr. 962 and 970. However, Mr. Flynn agrees that this allocation method would result in a larger user of electricity paying a disproportionate amount of universal service cost. Tr. 962. In fact, the Commission has already rejected this allocation method,"...because it would place a disproportionate responsibility for funding universal service and energy conservation programs on high [volume] kilowatt hour users in violation of Section 1301." Universal Service Order, Docket No. M-00960890F0010, (Order entered July 11, 1997) at 20 Section G.

In place of a strict kilowatt hour USC allocator, Duquesne proposes to allocate universal service costs in proportion to each classes' total distribution-related revenue requirement. Duquesne Statement No. 14-R at 25. As discussed below, the USC as proposed by the Company is in violation of the Competition Act. Consequently, the OSBA recommends that the Company be ordered to amend its filing such that universal service costs are allocated in a manner

that is consistent with the rate treatments contained in the Company's most recent base rate case.

The record in this proceeding is complete with information necessary to compute a USC that is consistent with the rate treatments that applied in the Company's most recent rate case. Using Exhibit JAL-1B, at 15 and 17, JAL-1D at 2-5, and OSBA Cross Examination Exhibit No. 1, Mr. Kalcic has provided a table comparing a true cost-based USC assignment with that proposed by Duquesne for the residential class. See Table 1 below.

TABLE 1

Duquesne Light Company
Company Versus Cost-of-Service Based
Residential Universal Service Cost Allocation

Acct.	Cost Study Allocation Factor	Universal Service Costs	Rate RA Allocation %	Rate RA Amount (1)*(2)	Rate RS Allocation %	Rate RS Amount (1)*(4)	Rate RH Allocation %	Rate RH Amount (1)*(6)	Total Residential (3)+(5)+(7)
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
901	39 - Cust Serv Costs	$529,095	0.3953%	$2,091	70.2351%	$371,611	3.2167%	$17,019	$390,721
903	39 - Cust Serv Costs	$4,074,030	0.3953%	$16,104	70.2351%	$2,861,400	3.2167%	$131,049	$3,008,552
904	13 - Avg. No. Cust	$6,137,500	0.4818%	$29,569	85.6040%	$5,253,948	3.9206%	$240,624	$5,524,141
908	13 - Avg. No. Cust	$1,375,647	0.4818%	$6,627	85.6040%	$1,177,609	3.9206%	$53,933	$1,238,170
926p	104 - Production	$63,656	0.3151%	$201	26.3979%	$16,804	3.0020%	$1,911	$18,915
926t	106 - Transmission	$2,511	0.2780%	$7	23.9606%	$602	2.0846%	$52	$661
926d	107 - Distribution	$39,652	0.3794%	$150	40.1546%	$15,922	3.6780%	$1,458	$17,531
931p	126 - Production	$31,828	0.3543%	$113	28.2913%	$9,005	3.5073%	$1,116	$10,234
931t	127 - Transmission	$1,255	0.2723%	$3	23.4697%	$295	2.0419%	$26	$324
931d	128 - Distribution	$19,826	0.3600%	$71	38.3237%	$7,598	3.4449%	$683	$8,352
	Total	$12,275,000		$54,937		$9,714,793		$447,872	$10,217,601
	Company Proposed USC Assignment (Per OSBA Cross-Exam. Exhibit No. 1)			$46,192		$5,266,035		$427,994	$5,740,221
								Shortfall	$4,477,380
									43.8%

Source:

Exh. JAL-1B, pages 15 & 17	OSBA Cross-Exam. Exhibit. No. 1	Exh. JAL-1D, pages 2-5	Exh. JAL-1D, pages 2-5	Exh. JAL-1D, pages 2-5

If universal service costs are properly allocated by account according to the allocation factor contained in the Company's cost-of-service study, the total residential class would be assigned $10,217,601 of the Company's total $12,275,000 universal service budget. Yet, the Company's universal service cost allocation for the entire residential class amounts to only $5,740,221. Clearly the allocation proposed by the Company for the USC does not match that of the Company's most recent base rate proceeding. In fact, the allocation would provide a significant reduction to the residential class in the amount of $4,477,380 or 43.8%.

Table 1 focuses solely on the Company's residential class. It is evident, however, that if the residential customers are receiving less than a cost-based allocation, some or all of the non-residential classes are receiving an over-allocation in order to recover the residential shortfall.

OCA witness Ms. Nancy Brockway recommends an alternative to Duquesne's proposed USC where costs would be assigned to rate classes using a non-production revenue allocation factor. OCA Statement No. 6 at 50. However, Ms. Brockway fails to address the extent to which her recommended allocator would be consistent with past ratemaking treatment. OSBA Statement No. 1R at 11. According to Exhibit NB-Duq-4, the OCA's preferred universal service cost allocator would reflect an assignment of just 44.8% of Duquesne's total universal service budget to the residential class.[5] Table 1 above shows that Duquesne's proposed USC encompasses a total residential allocation of 46.8%.[6] Therefore, the OCA's USC proposal would result in an even greater cost-shifting than the Company's

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[5] 44.8% equals the total sum of 0.4%, 41.1%, and 3.3%, representing the RA, RS, and RH classes respectively.

[6] 46.8% equals the total sum of the USC for the residential class as proposed by the Company, divided by the total universal service costs, $5,740,221/$12,275,000.

proposal. Consistent with the Commission's interpretation of the Competition Act, the OCA recommendation for use of a non-production revenue allocator must also be rejected.

XI. CONCLUSION

On the basis of the foregoing, the Office of Small Business Advocate respectfully requests that the Commission (1) approve the phase-in plan of Duquesne as filed, contingent upon the Company including provisions of its dispute resolution process with their Commission-approved customer education plan, or, alternatively, direct an accelerated phase-in as directed in the PECO Restructuring Order, (2) direct Duquesne to reduce its cost of capital percentage for its distribution revenue requirement to 8.86%, (3) allow Duquesne to functionalize distribution line losses as a generation-related cost, (4) allow Duquesne to allocate stranded costs to rate classes and capture the benefits associated with a seven year stranded cost recovery period, (5) allow Duquesne to provide an all-variable and a fixed/variable CTC rate charge to recover stranded costs, either to be selected by the customer based on the customer's needs and (6) direct Duquesne to provide a universal service charge that is consistent with the Company's most recent rate case treatments.

Respectfully submitted,

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Assistant Small Business Advocate

Date: February 10, 1998

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company For Approval Of Its Restructuring Plan Under Section 2806 Of The Public Utility Code	:	Docket No. R-00974104

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Re: Application of Duquesne Light Company for Approval of its Restructuring Plan, Docket No. R-00974104

Dear Mr. McNulty:

Enclosed for filing with the Commission in the above captioned matter are an original and nine (9) copies of the Brief of GPU Energy. Copies of this Brief have been served in accordance with the attached Certificate of Service.

Please note that counsel for PECO Energy Company has authorized me to state that PECO joins in section II of this Brief.

Please contact me if you require anything further in regard to this matter.

Very truly yours,

Terrance J. Fitzpatrick

Terrance J. Fitzpatrick

TJF/cc
Enclosures

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(Enclosure and diskette)
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(Via Hand Delivery)
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Office of Special Assistants

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(Via UPS Overnight)
All parties of record

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF DUQUESNE LIGHT COMPANY FOR APPROVAL OF ITS RESTRUCTURING PLAN UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE	:	Docket No. R-00974104

ORIGINAL

MAIN BRIEF OF GPU ENERGY

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

GPU Energy, the trade name for Metropolitan Edison Company ("Met-Ed") and Pennsylvania Electric Company ("Penelec"), respectfully submits this brief in the restructuring proceeding of Duquesne Light Company.

As stated in its petition to intervene (para. 9-10), GPU Energy has intervened in this proceeding for the narrow purpose of addressing the impact of the Commission's decision in this case on GPU Energy's restructuring proceedings at R-00974008 (Met-Ed) and R-00974009 (Penelec). In keeping with this narrow purpose, GPU Energy will limit its argument to two legal issues involving interpretation of the Electricity Generation Customer Choice and Competition Act ("Customer Choice Act", or "Act"), 66 Pa C.S. § 2801 et seq.

First, the Customer Choice Act requires the Commission to decide each electric utility's restructuring case, particularly stranded cost recovery issues, in light of that utility's particular circumstances. This case-by-case approach is apparent in sections of the Act distinguishing between different types of stranded costs, requiring evaluation of each utility's mitigation efforts, and requiring consideration of each utility's efforts undertaken prior to the Customer Choice Act to moderate customer rate levels while maintaining reliable service. Accordingly, in deciding this case the Commission should refrain from using broad, general language that some might interpret as having an impact upon the Commission's decisions in GPU Energy's restructuring proceedings.

Second, the Customer Choice Act does not permit the Commission to unilaterally reduce the three step phase-in process to, essentially, a two step process. The Act requires that one third of the peak load of each customer class be provided the opportunity for direct access on January 1 of three successive years -- 1999, 2000, and 2001. The Act authorizes the Commission to delay this schedule for two separate six month periods, but it does not allow the Commission to accelerate the schedule.

II. PHASE-IN OF CUSTOMER CHOICE[1]

B. Timetable for Phase-in

The Customer Choice Act does not authorize the Commission to order an electric utility to deviate from the phase-in schedule in the Act, under which one-third of the peak load of each customer class will be offered the opportunity for direct access on January 1 of three successive years -- 1999, 2000, and 2001.

In its decision in the PECO restructuring case at R-00973953 (Opinion and Order entered December 23, 1997), the Commission ordered that "33% of the peak load of each customer class shall have the opportunity for direct-access as of January 1, 1999 and that 66% of the peak load of each class shall have direct access as of January 2, 1999. All customers shall have direct access as of January 2, 2000." (Opinion, p. 45). Stephen Baron, a witness for the Duquesne Industrial Intervenors ("DII") in this proceeding, advocated a similar phase-in plan for large industrial and

[1] 1. PECO Energy Company joins in this section of the Brief.

commercial customers to avoid possible competitive disadvantage.[2] (DII Statement 1, pp. 60-62).

The phase-in schedule adopted by the Commission in the PECO restructuring decision and advocated by Mr. Baron in this proceeding is contrary to the plain language of Section 2806(b) of the Customer Choice Act, which reads as follows:

> **(b) Schedule.** - Recognizing that approximately 5% of the peak load will have retail access through pilot programs, the following schedule for phased implementation of retail access shall be adhered to unless a determination is made by the Commission under subsection (c):
>
> > (1) As of January 1, 1999, a maximum of 33% of the peak load of each customer class shall have the opportunity for direct access.
> >
> > (2) As of January 1, 2000, a maximum of 66% of the peak load of each customer class shall have the opportunity for direct access.
> >
> > (3) As of January 1, 2001, all customers of electric distribution companies in this Commonwealth shall have the opportunity for direct access.
> >
> > (4) The Commission shall establish regulations specifying that, within each customer class, the customers that are eligible for direct access prior to full direct access shall be determined on a first-come-first-served basis unless otherwise determined by the Commission through regulation, in the context of restructuring plans, or in other appropriate administrative proceedings, to prevent competitive disadvantages among similarly situated customers within a customer class.

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[2] While Mr. Baron advocated acceleration of the phase-in for large business customers, no witness advocated such an acceleration for residential customers. Moreover, with respect to Mr. Baron's argument, the Customer Choice Act authorizes the Commission to depart from the "first-come-first-served" approach to alleviate competitive disadvantages, but, for reasons set forth below, the Act does not authorize the Commission to accelerate the phase-in.

66 Pa. § 2806(b).

On its face, the above language expressly establishes a mandatory schedule in which one-third of the peak load of each customer class is given the opportunity for direct access in January of three successive years - 1999, 2000, and 2001.[3] Clearly, the purpose of such a phase-in is to introduce competition gradually to minimize the impact of any unforeseen problems when direct access is implemented, and to minimize the administrative burdens and any financial impacts on electric distribution companies ("EDCs").

The phase-in schedule advocated by Mr. Baron and adopted by the Commission in the PECO proceeding cuts one full year (minus one day) out of the phase-in schedule established in § 2806(b). The Commission did not provide the rationale for its accelerated phase-in in the PECO decision - leaving considerable room for speculation about the legal basis for such a conclusion. However, it appears that the Commission may have adopted this schedule based on an interpretation of the words "as of" which appear at the beginning of subparagraphs (b)(1), (2), and (3) to mean "at the latest" rather than "beginning on." Under this interpretation, the Commission could order an EDC to phase-in direct access to the second one-third of the peak load of each customer class on January 2, 1999, and the final one-third on January 2, 2000.

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[3] When the language of a statute is unambiguous, any further deliberation regarding its meaning is unwarranted. 1 Pa. C.S. § 1921(b), Meier v. Maleski, 670 A.2d 755 (Pa. Commw. 1996).

This interpretation of § 2806(b)of the Act is erroneous. Section 2806(b) establishes a three step phase-in beginning in January 1999 and ending January 1, 2001. While an EDC and its customers may agree in a settlement to expedite the phase-in of direct access, thereby waiving the Company's right under the Act to a more gradual phase-in, the Commission may not unilaterally cut a year out of the process.

It is clear that the Commission's interpretation of the phase-in language in its PECO decision is erroneous when one reads subsections (b) and (c) of § 2806 together. Section 2806(c) reads as follows:

> **(c) Additional time.** -
>
> (1) The Commission may determine that an additional six-month transition period is necessary **prior to the January 1, 1999, implementation date.** A determination under this subsection must be made at least 45 days *in* advance of the scheduled date for implementation and must be based on one or more of the following considerations:
>
> ***
>
> (2) Consistent with the considerations listed in paragraph (1), the Commission may determine that an additional six-month transition period is necessary. This determination must be made by the Commission by May 15, 1999.

66 Pa. C.S. § 2806(c)(Emphasis supplied).

The language of § 2806(c) supports GPU Energy's argument for two reasons. First, § 2806(c) establishes beyond doubt that January 1, 1999 is the "implementation date." In other words, January 1, 1999 is the date upon which the phase-in to direct access *begins*. There is no dispute over this point; no one in this

proceeding or elsewhere has advocated that the phase-in to direct access may begin before January 1, 1999.[4] Thus, the words "as of" at the beginning of § 2806(b)(1) can only mean "beginning on."

If the words "as of" in § 2806(b)(1) mean "beginning on," then those words must be given the same meaning in (b)(2) and (3). Commonwealth v. Maloney, 73 A.2d 707, 712 (Pa. 1950) ("the rule is well established that a word or phrase, the meaning of which is clear when used in one section of an Act, will be construed to mean the same thing in another section of the same Act.") Applying this interpretation to § 2806(b), beginning on January 1, 1999, a maximum of 33% of the peak load of each customer class shall be given the opportunity for direct access (§ 2806(b)(1)); beginning on January 1, 2000, a maximum of 66% of the peak load of each customer class shall be given the opportunity for direct access (subsection (b)(2)); and beginning on January 1, 2001, all customers shall be given the opportunity for direct access (subsection (b)(3)).

Second, it is clear that § 2806 does not delegate discretion to the Commission to adopt the accelerated phase-in schedule advocated by Mr. Baron and adopted by the Commission in its PECO decision. The introductory language to subsection (b)states clearly that "....the following schedule for phased implementation of retail access shall be adhered to unless a determination is made

[4] The Commission's Opinion and Order in the PECO proceeding referred to the phase-in schedule ordered therein as "the most rapid phase-in permitted under the Act...." (p. 45). While GPU Energy disagrees that this schedule is permitted under the Act, this statement shows that the Commission has treated January 1, 1999 as the earliest date for beginning the phase-in.

by the Commission under subsection (c):" The use of the word "shall" in this language indicates that the schedule was intended to be mandatory, not subject to the Commission's discretion. See Commonwealth v. Baker, 690 A.2d 164, 167 (Pa. 1997).

The only possible exception to the three year phase-in schedule is under subsection (c), which authorizes the Commission to delay the implementation of the direct access phase-in by two separate six-month periods. Thus, while the General Assembly expressly authorized the Commission to delay the phase-in, it did not authorize the Commission to accelerate the phase-in. The express inclusion of this one exception to the phase-in schedule set forth in § 2806(b)indicates that other exceptions were not intended. See Andrus v. Glover Construction Co., 446 U.S. 608, 617-618 (1980).

If any additional evidence of legislative intent regarding the phase-in schedule is necessary, it is contained in subsection (a) of § 2806, which reads as follows:

> **(a) General rule.** - The generation of electricity shall no longer be regulated as a public utility service or function except as otherwise provided for in this chapter at the conclusion of a transition and phase-in period beginning on the effective date of this chapter and ending, consistent with the Commission's discretion under this section, January 1, 2001. As of January 1, 2001, consistent with the Commission's discretion under this section, all customers of electric distribution companies in this Commonwealth shall have the opportunity to purchase electricity from their choice of electric generation suppliers. The ultimate choice of electric generation supplier is to rest with the customer.

This language leaves no doubt that the General Assembly intended the phase-in schedule to end on January 1, 2001 (not

January 2, 2000). The language "consistent with the Commission's discretion" refers to the explicit authorization granted to the Commission in § 2806(c) to delay the phase-in; as stated above, the Commission has not been authorized to accelerate the phase-in. Accordingly, subsection (a) of section 2806 reinforces the view that the accelerated phase-in schedule ordered by the Commission in the PECO proceeding violates the Customer Choice Act.

Finally, the Commission itself, prior to its PECO decision, had interpreted § 2806(b) in the manner urged by GPU Energy in this brief. In its order directing jurisdictional electric utilities to submit transition plans, Docket No. M-00960890, F.0003 (Order entered February 13, 1997), 176 PUR 4th 45 the Commission stated:

> We are mindful that the Act itself requires the restructuring of the Commonwealth's electric utilities in three phases, 66 Pa. C.S. § 2806(b)(1)-(3) [footnote deleted], culminating in a fully restructured industry with full customer access to competitive sources of electric energy *beginning January 1, 2001*. 66 Pa. C.S. § 2806(b)(3).

(Emphasis supplied.)

This language establishes clearly that the Commission interpreted § 2806(b) as providing for full customer access to competitive energy on January 1, 2001, not January 2, 2000, as in the PECO order. [5]

It is clear that while an EDC may agree to an expedited phase-

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[5] GPU Energy notes that the statutory construction issue raised by the Commission's resolution of the phase-in issue in the PECO proceeding was not briefed by the parties in that case. Since the issue has not been fully briefed before, GPU Energy urges the Commission to approach the issue with an open mind.

in pursuant to a settlement with its customers, the Commission may not unilaterally order such a company to phase-in the second one-third of its peak load to direct access prior to January 1, 2000, and the final one-third prior to January 1, 2001.

III. TRANSITION OR STRANDED COSTS

F. Recovery of Stranded Costs

1. Introduction

The Customer Choice Act mandates that the Commission adopt a case-by-case approach to determining the level of stranded costs that each EDC may recover.

The Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. § 2801 et. seq., requires each of Pennsylvania's EDCs to file a restructuring plan. 66 Pa. § 2806(d). The restructuring plan of Duquesne Light Company is scheduled to be decided by the Commission on May 29, 1998. The Commission is currently scheduled to decide the GPU Energy restructuring proceedings on June 15, 1998. Since the GPU Energy cases will be decided after Duquesne's, GPU Energy is concerned with any impact that a Commission decision in this proceeding may have upon the Commission's decision in these other proceedings.

The Commission's decision in this proceeding should have little, if any, impact upon its decisions in GPU's restructuring proceedings. One of the cornerstones of the Customer Choice Act is its requirement that the Commission treat each EDC according to its particular circumstances when making decisions on recovery of

stranded costs. Indeed, the Senate expressly rejected an amendment (A7963) that called for a 10% across-the-board rate cut for all ratepayers in the Commonwealth. 180 Sen. L.J. 2684-2695. Instead, as set forth below, the General Assembly required the Commission to examine the particular circumstances of each EDC in making decisions on stranded cost recovery.

This case by case approach is apparent in several sections of the Act. First, the standards for recovery of stranded cost in the Act distinguish between different types of stranded costs. The Act provides that the Commission "shall allow" recovery of utility costs related to contracts with non-utility generators ("NUGs"), including both payments to operating projects and payments to buy out, etc. NUG projects. 66 Pa. C.S. § 2808(c)(1),(2). In contrast, for costs related to generating facilities owned by a utility, the Act provides that the Commission shall determine the amount of such costs that it is "just and reasonable" for the utility to recover from ratepayers. 66 Pa. C.S. §§ 2804(13), 2808(c)(3). Accordingly, an EDC such as GPU Energy which has a large percentage of its stranded costs in the NUG category must be treated differently than an EDC which has a higher percentage of stranded costs related to its own generating facilities.

Second, the Act requires a case-by-case review of the adequacy of the mitigation efforts of electric utilities. The Act specifically provides that:

> "[t]he Commission shall consider [in determining the level of stranded cost that may be recovered via the competitive transition charge] the extent

> to which the electric utility has undertaken efforts to mitigate generation-related transition or stranded costs by appropriate means in a manner that is reasonable under all of the circumstances including consideration of whether mitigation has been commensurate with the magnitude of the electric utilities generation-related transition or stranded costs."

66 Pa. C.S.§ 2808(c)(4). GPU Energy does not take a position upon the adequacy of Duquesne's mitigation efforts. However, GPU Energy has introduced evidence of its own mitigation efforts in its restructuring proceedings, and the Commission's determination whether this mitigation has been adequate, and the impact this determination may have on stranded cost recovery, must be based upon that record.

Finally, the Act provides that "of equal importance to the mitigation efforts under paragraph (4), the Commission shall consider efforts undertaken over time, prior to the Act and enactment of this chapter, to reduce or moderate customer rate levels while maintaining safe and efficient operation." 66 Pa. C.S. § 2808(c)(5). Again, the Commission's evaluation of this factor, and its impact on stranded cost recovery, must be based upon the particular evidence in each EDC's restructuring proceeding.

In summary, the Customer Choice Act requires the Commission to tailor its decision in each EDC's restructuring case to the particular circumstances of that company. The Commission should recognize this case-by-case approach in its decision in this proceeding, and should refrain from using broad language that may

be interpreted as signaling how the Commission will rule in the restructuring proceedings of other EDCs.

IV. CONCLUSION

For the foregoing reasons, GPU Energy respectfully requests that the Commission recognize in this decision the requirement in the Customer Choice Act that it adopt a case-by-case approach to the restructuring proceedings of Pennsylvania's electric distribution companies, and that the Commission adhere to the phase-in schedule required by the Act rather than the accelerated schedule contained in the PECO restructuring proceeding.

Respectfully submitted,

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PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company for Approval of its Restructuring Plan	: : : :	Docket No. R-00974104

CERTIFICATE OF SERVICE

I hereby certify that I have this day served by UPS Overnight a true copy of the foregoing document upon the participants, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant.)

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February 10, 1998

VIA HAND DELIVERY

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Room B-20, North Office Building
Harrisburg, PA 17120

Re: Application of Duquesne Light Company for approval of Restructuring Plan Under Section 2806 of the Public Utility Code; Docket No. R-00974104

Dear Secretary McNulty:

Enclosed for filing are the original and nine (9) copies of the Main Brief of the Duquesne Industrial Intervenors ("DII") in the above-referenced proceeding.

As evidenced by the attached Certificate of Service, all parties are being duly served with the brief. Please date stamp the extra copy of this letter and return it for our filing purposes.

Very truly yours,

McNEES, WALLACE & NURICK

By Pamela C. Polacek
Pamela C. Polacek

Counsel to the Duquesne Industrial Intervenors

PCP/clc
Enclosures
c: Administrative Law Judge John H. Corbett, Jr. (w/ diskette) (via Federal Express)
Certificate of Service

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET. AL.	:	
v.	:	
DUQUESNE LIGHT COMPANY FOR APPROVAL OF ITS RESTRUCTURING PLAN UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE	:	DOCKET NO. R-00974104

MAIN BRIEF OF THE DUQUESNE INDUSTRIAL INTERVENORS

BOC Gases
General Motors Corp.
J&L Specialty Steel, Inc.
LTV Steel Company, Inc.
Nabisco Inc.
Nova Chemicals, Inc.
USX Corporation - US Steel Group

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Dated: February 10, 1998

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

A. Introduction

In December 1996, Pennsylvania took a major step toward economic revitalization with the passage of the "Electricity Generation Customer Choice & Competition Act," P.L. 802, No. 138, effective January 1, 1997, codified at 66 Pa. C.S. § 2801, et seq ("Act" or "Chapter 28"). The Act requires all investor-owned electric utilities in Pennsylvania to file with the Pennsylvania Public Utility Commission ("PUC" or "Commission") a restructuring plan to provide all customers within their service territories access to competitive market for electricity generation supply by January 1, 2001.[1] The restructuring plan filed by the Duquesne Light Company ("Duquesne," "DLC," or "Company") on August 1, 1997, is before the Commission for consideration in the instant proceeding.[2]

The Duquesne Industrial Intervenors ("DII") submits that the Duquesne Restructuring Plan is flawed in many aspects that will thwart development of, and transition to, a competitive electricity supply market.[3] DII further submits that the Duquesne proposal is inadequate on most major issues and must be rejected. DII offers strong counter-proposals to the Company's Restructuring Plan that must be accepted by the Commission in order to comply with the Act.

B. Summary of DII Argument

1. Stranded Cost Calculation

The Duquesne stranded cost calculation proposal is inadequate, improper, unjust and unreasonable. The Company performs no credible analysis of asset value in the competitive market in support of its stranded generation cost claim. Consequently, the DLC proposal fails the burden of proof with respect to this claim as set forth by the Commission. Company proposals to delay asset market valuation until 2003 are clearly contrary to the Act and must be rejected. In addition, Company reliance on a range of market prices forecasted by its witness does not meet the requisite statutory requirement that stranded costs be "known and measurable;" as such, DLC does not meet its burden of proof to

establish such costs by substantial evidence. Application of PECO Energy Company for Approval of Its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement & Petition of Enron Energy Services Power, Inc., for Approval of an Electricity Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(c) at the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order entered on December 23, 1997, ("PECO Restructuring Order") *slip op. at 68. Conversely, DII, performs a reliable market price projection and market* valuation of Duquesne's assets, as directed by the legislature and as adopted by the PUC, to establish its recommended level of stranded cost recovery.

Moreover, the regulatory asset portion of DLC's stranded cost claim is inflated and must be rejected. DII meticulously applies the Act's standards with respect to stranded generation-related costs and regulatory assets in arriving at its recommendation. The DII analysis is clearly reasonable and should be accepted by the Commission.

2. Competitive Transition Charge Calculation

The Act permits Duquesne to recover a just and reasonable level of its properly claimed, known and measurable, net stranded generation-related costs from ratepayers via a competitive transition charge ("CTC"). 66 Pa. C.S. §§ 2802(15), 2804(13) & 2808(a). The establishment of CTC charges could influence the ability and willingness of customers to participate in the competitive market during the transition period. *It is imperative under the Act that transition issues be decided in a manner that helps* foster development of the competitive market. Id. §§ 2802(7),(9), (12) & (13) & 2804(2) & (14) The DLC proposal to calculate the CTC yearly based on an annual reverse-RFP does not provide customers with the level of certainty needed to effectively participate in the competitive market. If the DLC proposal is accepted, a customer will not know CTC responsibility for the following year until the reverse-RFP is performed. Consequently, the customer will not be able to enter into otherwise desirable

long-term supply contracts. This artificial limitation on supply choices for customers in the Duquesne territory will inhibit the development of a competitive market, in direct contravention of the goals of the Act. In addition, the variable CTC methodology is consistent with the approach adopted by the Commission in the PECO proceeding, which provides for a fixed schedule of CTCs for each year of the transition period. See PECO Restructuring Order, slip op. at 109-113. Fairness and equity demand that Duquesne's customers be given an equal opportunity to effectively participate in the competitive market during the transition period. 66 Pa. C.S. §§ 2802(8) & 2804(14).

DII proposes to calculate a fixed schedule of yearly CTCs for the transition period. These CTCs are calculated based on a "CTC residual" methodology, in which the CTC is the portion of the bundled rate that remains after removing transmission and distribution charges and the expected market price of electricity for that year. The DII CTC calculation methodology will permit customers to effectively participate in the competitive market during the transition period. The DII proposal is reasonable and should be accepted by the Commission.

3. Tariff Related Issues

Duquesne proposes several tariff-related modifications that will clearly hinder customer competitive choices in Duquesne's service territory during the transition period. Duquesne proposes limits on Interruptible Service availability such that it will be available only to customers that begin taking service prior to December 31, 1998, and remain bundled sales customers taking full load from Duquesne. Such restriction is clearly inappropriate and contrary to the precedent, established in the PECO restructuring proceeding, that all customers must have the opportunity to participate in the market and that all current rate schedules must be unbundled on a non-discriminatory basis. PECO Restructuring Order, slip op. at 116-120. DLC also inappropriately proposes to limit its Time of Day rate service to customers who begin taking service prior to December 31, 1998. In addition, Duquesne fails to unbundle its "Rule 4" contracts, again in clear violation of the Act's mandate that all customer

classes have the opportunity to "shop" in the competitive market. To remedy this deficiency in the Duquesne Restructuring Plain, DII offers a method for unbundling Rule 4 contracts that is similar to the method used by the Company with respect to Interruptible Service. Furthermore, Duquesne inappropriately proposes to eliminate economic development incentives for current customers as contracts expire before the end of the transition period. Current offerings must be maintained throughout the transition period in order to prevent rate cap violations and/or inappropriate cost-shifting. Because Duquesne plans to offer economic development initiative rates to new customers the attempt to eliminate those rates for existing customers is unreasonably discriminatory and must be rejected.

4. Phase-in

Duquesne proposes a schedule for the phase-in of direct access and a method of choosing the participants in the first two phases of direct access that are inappropriate under the Act. The Act permits the Commission to establish an "accelerated phase-in" such that all customers in the Duquesne service territory will have access to the competitive market on January 2, 2000. The Commission adopted a similar accelerated phase-in in the PECO proceeding and should consistently apply this precedent in order to expedite access the benefits of competitive markets for all Commonwealth consumers. PECO Restructuring Order, slip op. at 46-49. Duquesne inappropriately proposes to select commercial and industrial customers for the first two phases of direct access via SIC code-based market segment. Such methodology is contrary to the Act's recommended "first-come, first-served" methodology, and will hinder development of the competitive market. DII proposes that all customers desiring to participate in the first two phases of direct access be able to do so based on a pro-rata reduction of load on direct access, if any stage is over-subscribed. This will allow a maximum number of customers access to the competitive market and accelerate transition to full competition. This Commission also adopted a similar proposal for phase-in of industrial and commercial customers in the PECO proceeding. Application of PECO Energy Company for Approval of Its Restructuring Plan Under Section 2806 of

the Public Utility Code and Joint Petition for Partial Settlement & Petition of Enron Energy Services Power, Inc., for Approval of an Electricity Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(c) at the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Order on Reconsideration entered on January 16, 1998 slip op. at 22 ("PECO Reconsideration Order") (attached in Appendix D).

5. Transmission and Distribution Rates

Duquesne has inappropriately unbundled its distribution and transmission rates such that those rates are inflated. This results in the Company being compensated twice for some costs and may result in a lower generation credit that may inhibit customer ability to economically participate in the deregulated market. As detailed in this brief, the Company's proposals are clearly unreasonable and must be rejected.

II. PHASE-IN OF CUSTOMER CHOICE

A. Method of Customer Selection

One of the most important short-term issues in this proceeding is determination of which customers will be given the opportunity to participate in the first two phases of direct access. 66 Pa. C.S. § 2806(b).[4]

Duquesne proposes to phase-in industrial and large commercial customers by SIC code-based market segments, with the order based on the percentage response of customers within the segments to the Company's pilot program solicitation. Duquesne Statement No. 6, p. 4; See Duquesne Statement No. 6-R, p. 9, Exhibit FAH-1 (results of pilot enrollment).[5]

The Duquesne customer selection proposal is clearly inappropriate under the Act. First, the Act directs that the percentage of participation be determined based on "the peak load of each customer class." 66 Pa. C.S. § 2802(b)(1) & (2). The Duquesne proposal inappropriately merges the commercial

and industrial customer classes. The Act's clear mandate requires consideration of each class separately. Id. In addition, DLC readily admits that phasing an entire segment, as a group, may cause Duquesne to exceed the maximum participation levels in the Act. Tr. at 1027. Although it is desirable to allow as many customers to access the competitive market as soon as possible, the DLC phase-in proposal's incongruity with the Act's requirements illustrates that the DLC phase-in proposal is inappropriate, unwarranted and not contemplated under the Act.

Second, Duquesne's purported rationale for utilization of pilot enrollment to determine the order for phase-in is flawed. Duquesne uses the pilot enrollment solicitation response as a proxy for customer interest in participating in the competitive market during the transition period. As DLC states: "Duquesne did not control which segments were in the first phase — the customers within those segments did." Duquesne Statement No. 6-R, p. 10. DLC concedes, however, that a customer's desire to participate in the pilot may have been influenced by many factors other than the bona fide interest to obtain competitive supply. Tr. at 1021. This admission undermines the Company's assertion that its phase-in proposal is based on customer interest and choice.

Third, the Company's willingness to rely on customer response during a truncated solicitation period is inconsistent with its general aversion to a "first-come, first-served" approach to phase-in. DLC objects to a first-come, first-served approach as inequitable because customers may not be equally informed about benefits of accessing competitive supply and the procedural aspects of enrolling in the program. Duquesne Statement No. 6-R, p. 7. The SIC market segment ranking, however, is essentially a first-come, first-served methodology in which the opportunity to become informed and decide to participate is limited in time. Under the DLC phase-in proposal, market segments containing businesses that are more informed of the pilot solicitation benefit for the entire phase-in period. Instead of conducting a phase-in solicitation to determine customers that want to participate in the first two stages of phase-in, Duquesne is willing to rely on a snap-shot of interest based on the pilot solicitation, which

the Company admits may be distorted by factors other than bona fide interest in accessing competitive supply. Tr. at 1021. This may result, ironically, in a customer that has no interest in accessing competitive supply and did not respond to the pilot solicitation being permitted access in the first phase-in stage because other members of the SIC segment responded to the pilot solicitation; while a customer that has great interest in accessing competitive supply and did respond to the pilot solicitation being denied access until the final stage. See Tr. at 1017-1018 &1019. DII submits that this illogical result must be avoided.

DII proposes an alternative phase-in method that will afford fair treatment of all customers with less competitive disadvantage situations. Under the DII proposal, subscription for each stage of phase-in will occur on a first-come, first-served basis unless a class is over-subscribed. In such event, each customer nominating a portion of load in the over-subscribed class will experience a pro-rata reduction in their nominated load, such that the total load available for direct access in that class meets the Act's requirements. DII Statement No. 1, pp. 60-61. The Commission adopted an identical proposal for the phase-in of industrial customers in the PECO service territory. PECO Reconsideration Order, slip op. at 22. The DII method has two distinct advantages.

First, the DII method eliminates possible competitive distortions that could occur if some industrial or commercial customers are permitted to participate in alternative access for their full load, while other similarly situated customers are denied participation because of the load cap. Under the DII proposal, all customers have an equal percentage of load provided by a competitive supplier. See DII Statement No. 1, pp. 60-61. The DII method is thus fair to all customers.

Second, the DII method maximizes the number of participants in the first two stages of phase-in. All customers that desire to participate in the first two stages and notify Duquesne requesting to be included are assured that at least one-third of their load will be competitively provided on January 1, 1999, and at least two-thirds in the next stage.

The Company has indicated that it is willing to adopt the DII pro-rata approach, if customers indicate a preference for the DII method. Tr. at 1049-1050. DII submits that the support of the proposal by the large industrial customers participating in this proceeding and the Pennsylvania Retailers' Association is sufficient indication of support for the pro-rata approach. See PRA Statement No. 1, pp. 6-9. The interested parties in this proceeding support use of the DII pro rata approach; consequently, DII submits that its proposal must be used in this proceeding because customers want it and the PUC has already approved it for PECO.

The Duquesne proposal to phase-in industrial and commercial customers based on SIC market segment is inappropriate and must be rejected. The DLC proposal does not treat each customer class separately as required by the Act. See 66 Pa. C.S. § 2808(b). The DLC proposal also violates the requirements of the Act by permitting the 33% or 66% threshold applicable to the stages of phase-in to be exceeded. Id. Conversely, DII presents a phase-in approach that permits a maximum number of customers to participate in the first two stages of phase-in without violating the Act. The DII methodology, as endorsed by the Commission in the PECO restructuring proceeding, is reasonable and should be adopted by the Commission.

B. Timetable for Phase-in

Duquesne proposes to phase-in at least 33% of its combined industrial and commercial peak load on January 1, 1999; at least 66% of its industrial and commercial peak load on January 1, 2000; and, the remainder of its industrial and commercial peak load on January 1, 2001. Duquesne Statement No. 6, p. 3. DII proposes an accelerated phase-in timetable that complies with requirements of the Act and will eliminate many possible competitive disadvantages of DLC's proposed phase-in. DII Statement No. 1, pp. 60-63.

To eliminate any disproportionate effects of phase-in, DII proposes that Duquesne offer one-third of its load to direct access on January 1, 1999, the second one-third on January 2, 1999, and the

final third on January 2, 2000. Id. at 61-62.[6] The Act establishes annual maximum participation targets for 1/1/1999, 1/1/2000, and 1/1/2001. The day after each target date, the next participation limit becomes effective. The Act does not establish a one-year period in which only the minimum amount of load can have direct access; rather, the Act simply establishes the next target and a maximum level that cannot be exceeded **on that date**. This accelerated phase-in methodology was adopted by the Commission in the PECO restructuring proceeding in order to "provide the benefits of competition and complete the transition process as early as possible." PECO Restructuring Order, slip op. at 48. The PUC's prior interpretation of the Act is reasonable and is consistent with the goal of maximizing customer access to the competitive market. The Commission should again adopt the accelerated phase-in, as proposed by DII, as the true, correct and most equitable interpretation of Section 2806(b).

The accelerated phase-in also eliminates many potential competitive disputes. Two years is a lengthy period for commercial and industrial customers to be denied access to the competitive generation supply market when competitors have such access. Compressing this period to one year will significantly lessen any negative effect. The Commission cited the minimization of competitive disadvantages as an additional reason supporting adoption of the accelerated phase-in for the PECO territory. PECO Restructuring Order, slip op. at 49.

Duquesne's proposal to phase in at least 33% of its peak load for the combined industrial and commercial classes on January 1, 1999, followed by at least 66% on January 1, 2000, and all load on January 1, 2001, does not meet the requirements of the Act and must be rejected. An accelerated phase in proposal, as proposed by DII and accepted by the Commission in the PECO restructuring proceeding, is permissible under the Act and should be accepted in order to speed the availability of competitive supply. Customers in the Duquesne territory deserve the same accelerated access as provided by the Commission to customers in PECO's service territory.

III. TRANSMISSION AND DISTRIBUTION RATES; UNBUNDLING ISSUES

A. Introduction

Duquesne submits with its filing an unbundling analysis that divided current rates into transmission, distribution and generation components. Duquesne Statement No. 5, p. 18, Exhibit No. JAL-1. For purposes of this proceeding, DII conceptually accepts the Company's unbundling analysis with the specific exceptions addressed below. DII Statement No. 1, p. 36. DII objects to the Company's use of a "required" rate of return, rather than the rate of return realized from various classes in current rates; the inclusion of distribution losses in DLC's distribution rates; and, the Company's failure to include all generation-related ancillary services in the generation component of the unbundled rates. See Id. at 36-47.

B. 1996 Test Year Cost of Service

DII provisionally accepts the Company's 1996 test year Cost of Service, with the adjustments discussed below, as the rate unbundling starting point. DII Statement No. 1, p. 36.

C. Required v. Realized Rates of Return

In its unbundling of rates, Duquesne uses a rate of return on rate base at its requested cost of capital in this proceeding. DII Statement No. 1, p. 41. Duquesne refers to this as its "required" rate of return. Use of a "required" rate of return is clearly an inappropriate cost-shift and a violation of the Act's rate cap. 66 Pa. C.S. §§ 2808(a), 2804(7) & 2804(4)(i). DII submits that Duquesne must use the realized rate of return for each class as established in its last base rate case. See DII Statement No. 1, pp. 41-42.

Duquesne requests as part of this proceeding a rate of return of 9.61%. Duquesne Statement No. 4-R, p. 35. Duquesne's current bundled rates, however, do not reflect a uniform compensation by rate schedules based on this required rate of return. DII Statement No. 1, p. 41-42. Instead, the current bundled rates reflect the earned rate of return produced by each rate class as established in Duquesne's

last base rate proceeding. Id. The use of a rate of return either above or below the rate of return embedded in bundled rates creates cost shifting , which is prohibited under the Act, and violates the rate cap on the components of transmission and distribution rates as of January 1, 1997. 66 Pa. C.S. §§ 2808(a) , 2804(7) & 2804(4)(i).

First, the use of required rate of return rather than earned rate of return shifts costs between the distribution function and the generation function of the unbundled rates. DII Statement No. 1, pp. 41-42. "Any rate of return excess or deficiency (above or below the equal rate of return value) shows up in the generation component of each class' unbundled rate under the Company's analysis." Id. at 42.[7] Although moving class rates of return closer to system average may be appropriate in other contexts, the Act requires that, in order to prevent cost shifting, individual components of distribution rates must be capped at the January 1, 1997, levels until July 2001, or the time when the utility is no longer collecting a CTC, whichever is shorter. 66 Pa. C.S. § 2804(i). When costs are shifted from the generation component to the distribution rates, the distribution rate will exceed the rate authorized as of January 1, 1997. Because the rate cap will be violated by using the Company's "required" rate of return, the DLC unbundling analysis must employ the rate of return currently embedded in each class' distribution rates. DII Statement No. 1, p. 41-42.

Second, by changing the size of the generation component, use of the required rate of return in the unbundling analysis shifts responsibility for the recovery of stranded costs through the CTC under the DII and Duquesne approaches to CTC calculation. Id. at 41-42. Both DII and DLC use a "CTC residual" methodology in which the yearly CTC is determined by subtracting the anticipated market price for that year from the total generation component of the unbundled rate. DII Statement No. 1, p. 36; Duquesne Statement No. 5, pp. 56-68. See Section V, infra.[8] As previously explained, the Company's use of required rate of return shifts the costs from distribution to generation (or vice-versa), either raising or deflating the generation component of the class's rate. DII Statement No. 1, p. 42.

Because the market price will be established separately from the unbundling analysis and will not be influenced by whether required or realized rate of return is used in the unbundling analysis, a change in the total generation component of the unbundled rate changes the residual portion of that generation component - the CTC. Thus, a higher (or lower) CTC may be charged to some classes based on whether that company is currently earning DLC's "required" rate of return. This result is directly contrary to the Act's mandate that stranded costs be recovered in a manner that does not affect an inter- or intra-class cost shift. 66 Pa. C.S. § 2808(a).

Duquesne's unbundling analysis inappropriately employs the Company's "required" rate of return in establishing distribution rates. The Duquesne proposal to use its required rate of return in the unbundling of rates is clearly a cost-shift, resulting in both a shift of costs between the distribution and generation functions and a shift of stranded cost liability (if the CTC residual methodology is used). Both types of cost shifting are prohibited by the Act. 66 Pa. C.S. §§ 2808(a) & 2804(7).

In addition, the use of the "required" rate of return violates the rate cap on distribution rates. 66 Pa. C.S. § 2804(4)(i). Duquesne is able through its proposal to ensure recovery of excessive costs in its monopoly rates, which no customer can avoid. If these costs are not shifted to the monopoly function, the costs will remain in the generation component of rates and potentially be lost by DLC in the competitive market. This attempt by DLC to shelter costs from competition is clearly inappropriate.

The use of the "required" rate of return in unbundling rates violates the rate cap and anti-cost shifting provisions of the Act. The Company's proposal is clearly an inappropriate attempt to shift costs to regulated monopoly distribution rates. DII submits that the DLC unbundling analysis must be rejected by the Commission.[9]

D. Distribution Losses

Compensation is embedded in current bundled rates for electricity losses experienced as electricity moves along distribution lines. These losses are commonly referred to as "distribution

losses;" however, the actual costs embedded in rates are for extra generation that must be reserved to compensate for the lost electricity. In effect, more energy must be produced by a generator than will actually be needed by the end-user because some electricity will be lost as it moves along the distribution path.[10]

In its rate unbundling proposal, Duquesne included compensation for distribution losses in its unbundled distribution rates at embedded cost. Duquesne Statement No. 5, p. 12; DII Statement No. 1, p. 39. This distribution loss treatment is inappropriate because distribution losses are more closely associated with the generation function and not with the distribution function. Duquesne Statement No. 1, p. 41. The Act requires that costs associated with generation be included in the generation component of the unbundling analysis. Duquesne's inclusion of generation costs in its distribution function is an inappropriate cost shift pursuant to the Act. 66 Pa. C.S. §§ 2808(a) & 2804(7); DII Statement No. 1, p. 41.

In addition, the inclusion of so-called distribution losses in the Company's distribution rates ignores the reality that loss compensation services can be competitively procured. DII Statement No. 1, p. 39. Alternative suppliers will be able to offer customers loss compensation capacity and energy at market-based rates. Id. Distribution rates established in this proceeding will be in effect for at least 54 months from the effective date of the Act. 66 Pa. C.S. § 2804(4)(i). Under the Act, distribution remains a monopoly function that can only be provided by Duquesne. Id. § 2802(16). If the loss compensation services remains assigned to distribution rates, any customer that obtains the services from an alternative supplier will be paying twice for the services. DII Statement No. 1, p. 39. Duquesne is attempting to ensure that it will be able to continue to recover as much of its current earnings as possible via the rates for monopoly services that every customer must pay. Id. With respect to distribution losses, the Company proposes to maximize recovery for services that it may not provide to customers. The Commission must prohibit Duquesne from exploiting its monopoly business by charging customers

for services that the customer does not receive from Duquesne.

The Company accepted DII's proposed change and reallocation of distribution losses to the generation function with the potential for competitive procurement. Duquesne Statement No. 5-R, pp. 21-22.

> Duquesne has no objection to removing the cost of losses from its distribution tariff and making them available at market-based prices or allowing suppliers to competitively procure their own distribution losses.

Id. at 22. Consequently, the dispute between DII and DLC over the distribution loss issue should be terminated.

DLC inappropriately includes so-called distribution losses as part of distribution rates. DII objects to this inclusion in distribution rates because it is a cost-shift of generation-related costs to the distribution function. In addition, inclusion of the loss compensation services in the regulated distribution rates is inappropriate because loss compensation services will be subject to competitive provisions as a generation-related function. The Commission should require that the unbundling analysis performed by Duquesne as part of its compliance filing treat distribution losses as part of the unbundled generation component of rates.[11]

E. Ancillary Services

As customers become familiar with the competitive market, they will realize that many components of electric service are not included on current bills. These components include various ancillary services that were previously provided at embedded cost within bundled rates in order to ensure the reliability of the electricity system.[12] Duquesne includes ancillary services in its transmission rates. See Duquesne Statement No. 5, pp. 18-24.

Inclusion of generation-related ancillary services in DLC's unbundled transmission rates is inappropriate because it shifts costs between functional categories. DII Statement No. 1, p. 37. Generation-related ancillary service costs are not included in DLC's current transmission rates. DII

Statement No. 1-S, p. 15. Consequently, these costs can not properly be assigned to the transmission function in unbundling DLC's rates pursuant to the Act. 66 Pa. C.S. § 2804(3).

In addition, as electric industry restructuring proceeds on both the national and state level, it is apparent that many ancillary services, including the ones at issue in this proceeding, can be provided by alternative suppliers in a competitive market. DII Statement No. 1-S, p. 15. Consistent with the general deregulation of generation services embodied in the Act, customers must be given options to purchase such competitive ancillary services from alternative suppliers. Concurrent with the emergence of customer options to procure alternatively supplied ancillary services, ancillary services costs must be removed from Duquesne's transmission rate to avoid any double payment for these costs. Id. If the ancillary service costs are not removed from transmission rates, DLC customers will be forced to pay twice for these services -- once to the alternative supplier from whom customers nominally procure ancillary services and once to DLC as part of the regulated transmission rate. Id. To prevent inappropriate double payment, DII recommends moving $18 million of ancillary service costs from the transmission rates into the market price component of unbundled generation rates. DII Statement No. 1, p. 37.

DII makes two adjustments to the DLC unbundling analysis in order to properly account for generation related ancillary services. The first adjustment involves the reactive supply and voltage control ancillary service. The second adjustment involves the remaining generation-related ancillary services.

First, to adjust the Duquesne unbundling analysis for reactive supply and voltage control ancillary service, DII removes the proposed cost (as stated by Duquesne) from transmission rates and adds the Company's proposed reactive supply and voltage control cost to the DII market price for each year. DII Statement No. 1, pp. 37-38. This DII adjustment ensures that customers will not pay twice for reactive supply and voltage control ancillary service. Id. at 37.

Second, DII adjusts the Duquesne unbundling analysis to properly account for other generation-related ancillary services. The other ancillary services must be procured as a percentage of the customer's load. Id. at 38. Consequently, DII employs a 15% reserve margin adder to the market capacity prices calculated by DII for each customer class. Id. The rationale for this treatment is as follows:

> Since these generation related ancillary services are determined as a percentage of load, [DII has] included the cost of all of these services through the application of a 15% reserve margin adder to the market capacity prices calculated for each customer class. Essentially, by applying a 15% reserve margin adder, [DII has] accounted for generation related ancillary service charges (other than reactive supply and voltage control) at market-based prices. This is also consistent with the assumption that [DII] made in our stranded cost quantification; i.e., that all generating capacity would receive market-based capacity revenues. Furthermore, since all electric generation suppliers service firm load will carry a reserve margin for reliability purposes, the reserve margin adder must be included in market prices for generation and not in the transmission component.

Id. Generation-related ancillary services costs must appropriately be assigned to the generation function. DII Statement No. 1-S, p. 15. The DII adjustments to DLC's unbundling analysis ensure accomplishment of this result.

The Company agrees that generation related ancillary services that can be competitively supplied should be removed from the transmission rate. Tr. at 720-721. Because all generation-related ancillary services are not currently subject to competition, the Company's adjustment would result in only a partial removal of ancillary service costs from the transmission rate. Presumably, as more ancillary services are competitively provided, the Company would then remove such costs from its transmission rate. This piecemeal approach to unbundling is not satisfactory; DII offers a sufficient and more equitable course to pursue. All generation-related ancillary services must be removed from the transmission rate and the Company may charge customers for any generation-related ancillary service not competitively procured. DII Statement No. 1-S, p. 15. This approach is consistent with the current treatment of generation-related ancillary services. The Company's position is once again aimed at maximizing its recovery through its monopoly rates. In order to do so, it is willing to inappropriately

assign generation-related costs to its transmission rates.

In the event the Commission does not accept DII's proposed treatment of ancillary service costs, other changes to both the Duquesne Restructuring Plan and the DII analysis of that plan must be made. First, the Company's unbundling analysis includes generation-related ancillary services at embedded costs. DII Statement No.1-S, p. 15. To the extent that the Company's proposal is accepted and the Company continues to be compensated for competitive ancillary services at the embedded costs, ratepayers must receive a credit toward stranded costs for those services. Id. If the embedded costs of these generation-related ancillary services exceed market revenues, the difference between the embedded cost and the market price must be credited against any stranded cost liability that the Company imposes on its customers. Id. Second, DII includes generation-related ancillary services in its market price analysis at the market price for procuring those services. To the extent that the Duquesne proposal to include any or all of these costs in the transmission rate at embedded cost is accepted by the Commission, the DII market price forecast and stranded cost calculation should be adjusted to reflect the Company's ability to receive greater compensation for these services (at embedded costs as opposed to market price). Id. at 15-16.

Duquesne inappropriately fails to treat generation-related ancillary service costs as part of the generation component in its unbundling analysis. This results in cost shifting and in the possibility that customers will be forced to pay both Duquesne and an alternative supplier for these services. DII's adjustments to the Duquesne analysis prevent this possibility by removing $18 million of ancillary service costs from the transmission component and assigning these costs to the generation component. In order to fairly and equitably unbundle rates, DII respectfully requests that the Commission accept the DII treatment of ancillary service costs.

F. Voltage-Differentiated Rates

DII is not addressing this issue but may respond, as appropriate, in its reply brief.

G. Other Issues

DII is not addressing any additional transmission and distribution rate issues at this time; DII may respond to other parties' proposals, as appropriate, in reply brief.

H. Conclusion

As recognized by the Commission in the PECO restructuring proceeding, "One of the primary issues in this proceeding involves the requirement that [the electric distribution company] 'unbundle', or separate, services, tariffs and customer bills to provide separate charges for generation, transmission and distribution. 66 Pa. C.S. § 2804(3)." PECO Restructuring Order, slip op. at 49. Although the Duquesne Cost of Service Study is an appropriate starting point for the unbundling of the Company's rates, it is inadequate and incomplete. DII shows that several adjustments must be made to comply with the unbundling, rate cap, and anti-cost shifting provisions of the Act. The DII adjustments prevent the Company from inappropriately inflating its monopoly services rates to the detriment of ratepayers and the development of the competitive market. DII's unbundling analysis for Rates, RS, L, and HVPS incorporates these adjustments. See DII Statement No. 1, pp. 46-47, Exhibit Nos. SJB-7, SJB-8 and SJB-9. The DII adjustments regarding rejection of realized rate of return, distribution losses and ancillary services are clearly appropriate; DII respectfully requests that the PUC adopt the DII adjustments to the Duquesne unbundling analysis.

IV. TRANSITION OR STRANDED COSTS

A. Overview of Stranded Cost Valuation and Recovery Approaches

1. Introduction

The Commission must adhere to two primary sources of guidance when making stranded cost determinations in this proceeding. First, the Commission must follow the dictates of the Public Utility Code, 66 Pa. C.S. § 101, et seq, and the specific standards for the restructuring of the electric industry embodied in Chapter 28 of that Code, 66 Pa. C.S. § 2801, et seq. ("Chapter 28" or "Act"). Second, the

Commission must acknowledge its own precedent in administrative decisions implementing the Act or addressing issues regarding stranded cost recovery.

These sources provide guidance for two contested issues in this proceeding. First, the Act, and the PECO QRO and restructuring decisions establish the framework and burden of proof for the determination of DLC's properly recoverable stranded costs. This standard applies to both Duquesne's stranded generation cost claim and its regulatory asset claim. Second, the Act and the Commission's decision in the PECO restructuring proceeding prohibit recovery of Duquesne's claimed future fossil decommissioning costs.

(a) Stranded Cost Determination

Four sections of Chapter 28 provide the foundation for the determination of Duquesne's stranded costs to be recovered in this proceeding. Section 2803 provides a definition of "stranded costs." 66 Pa. C.S. § 2803. Sections 2802 and 2804 explain the Commission's duty with respect to competitive transition charges and determination of levels of stranded cost recovered from ratepayers. Id. §§ 2802(8), 2802(15) & 2804(13). Section 2808 establishes principles that the Commission must follow with respect to quantifying the amount of different categories of stranded costs to be recovered from ratepayers through the CTC.[13] Id. § 2808(b). Read together, Chapter 28 mandates a three-step process for the Commission to determine the amount of utility's stranded costs to be recovered from ratepayers.

First, the Commission must determine whether the utility's purported "transition or stranded costs" are properly claimed under Chapter 28. In arriving at this determination, the Commission must interpret and apply the standards for electricity restructuring in Section 2804 and the definition of "transition or stranded costs" in Section 2803. Section 2803 defines transition or stranded costs as follows:

> An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation

market and which the Commission determines will remain following mitigation by the electric utility.

Id. § 2803. This definition provides at least the following five requirements for a cost to be considered a stranded cost:

(1) generation related;

(2) known and measurable;

(3) netted against all other generation-related costs;

(4) traditionally recoverable in a regulated environment, but not recoverable in a competitive market; and

(5) determined by the Commission to be remaining after mitigation.

Only costs that satisfy all five criteria are properly claimed as stranded or transition costs pursuant to Chapter 28. Id. If a "stranded cost" claimed by Duquesne does not satisfy all requirements in the definition, it can not properly be considered for ratepayer recovery pursuant to the Act.

Second, the Commission must determine the correct quantification of the properly claimed stranded or transition costs. In doing so, the Commission must weigh the evidence presented in the proceeding and determine whether the Company met its burden of proof with respect to the proper amount to be considered for recovery. Id. §§ 315(a) & 332(a). The Commission established the following burden of proof for the stranded cost determination in the PECO restructuring proceeding:

> In summary, in order to recover each component of the requested amount, PECO has the burden to prove, based on substantial evidence in the record, that each request would recover the net present value of the unmitigated, net, known and measurable generation related expense within the definition of stranded costs. PECO has the burden to prove that such costs would have been recoverable under traditional regulation but will not be recoverable in a competitive market.

PECO Restructuring Order, slip op. at 68. Clearly, the same standard, with the burden of proof based on substantial evidence, must be placed on Duquesne in this proceeding. To employ a different burden of proof would be unfair and inequitable. See 66 Pa. C.S. §§2804(14) & 2802(8).

With respect to stranded costs, the utility must show its claim to be known and measurable. 66

Pa. C.S. § 2803. For example, if the utility claims $40 million in consumer education costs related to restructuring (which are properly recoverable under Chapter 28 as transition costs) but can only satisfy the burden of proof that $35 million will actually be incurred in implementing the consumer education plan, then only $35 million should be considered by the Commission for recovery as stranded costs. In addition, the Commission must ensure that the stranded costs are valued on a net present value ("NPV") basis. Id. The PECO restructuring proceeding established that costs must be valued at a NPV basis as of January 1, 1999. PECO Restructuring Order, slip op. at 66.

As shown throughout this brief, Duquesne fails to satisfy its burden of proof with respect to numerous components of its stranded cost claim. The most egregious failure is Duquesne's stranded generation cost claim. In its direct testimony, Duquesne fails to provide a definitive determination of stranded generation costs, proposing instead that the Commission delay determination of the market value of its assets until 2003 based on an arbitration panel decision. Both the Act and the PECO precedent clearly indicate that a one-time determination of stranded generation costs as of December 31, 1998, is necessary.[14] See 66 Pa. C.S. §§ 2803 & 2808(f); PECO Restructuring Order, slip op. at 80. Duquesne provides alternative methods to establish asset market value that similarly delay determination. In addition, Duquesne fails to appropriately quantify several stranded regulatory assets in a manner that increases its stranded cost claim. Furthermore, Duquesne inappropriately claims "stranded" regulatory assets that are not net costs and will be recovered by other portions of its stranded cost claim.

Third, the Commission must determine the just and reasonable amount of properly claimable, properly quantified stranded costs to be recovered from ratepayers through the CTC. 66 Pa. C.S. § 2804(13). Utilities have the opportunity to recover a just and reasonable level of qualifying stranded costs via a competitive transition charge ("CTC") to be paid by customers accessing the utility's transmission and distribution network. Id. §§ 2802(15) & 2808(a). The Act places upon the

Commission a specific duty with respect to approval of a CTC. The Commission has the power and duty to approve a CTC only for the amount of transition or stranded costs it determines to be just and reasonable to recover from ratepayers. Id. § 2804(13); PECO Restructuring Order, slip op. at 63-68. Thus, in determining transition or stranded cost levels to be recovered from ratepayers the Commission must exercise its regulatory discretion to strike an appropriate balance between the interest of shareholders, ratepayers, and new entrants to the competitive electric generation market. 66 Pa. C.S. § 2802(8); Pennsylvania Public Utility Commission v. Pennsylvania Gas & Water Co., 492 Pa. 326, 424 A.2d 1213 (1980), certiorari denied 454 U.S. 824.

Section 2803 establishes three broad categories of potential stranded costs: (1) net plant investments and costs attributable to utility's existing generation plants and facilities ("stranded generation"); (2) regulatory assets and other deferred charges typically recoverable under current regulatory practice ("regulatory assets"); and, (3) non-utility generation contract buyout costs ("NUG costs"). 66 Pa. C.S. § 2803. The Commission recognized that the Act provides differing treatment for the determination of recoverable of stranded generation costs (as opposed to regulatory assets and NUG costs) in the PECO restructuring proceeding.

> In contrast to Section 2808(c)(1) and (2) claims that are fully recoverable, once a Section 2808(c)(3) claim is proven to exist as a stranded cost within the definition in the Act, the Commission must authorize a "just and reasonable" amount for recovery.

PECO Restructuring Order, slip op. at 67. The DII proposals for arriving at the "just and reasonable" level of stranded generation costs to be recovered through the CTC are discussed in detail in Section IV.F, infra. In addition, an application of the above-explained three-step process to each category precedes the relevant sections of this brief.

(b) Future Fossil Decommissioning Expense

Duquesne claims the future costs of decommissioning its fossil units as a component of its stranded cost in this proceeding. Duquesne Statement No. 4, pp. 18-19. The Company bases this claim

on fossil decommissioning studies performed for use in this proceeding. Id. Recovery of future fossil decommissioning costs is inappropriate under the applicable Commission and appellate court precedent.

In the PECO restructuring decision, the Commission rejected a claim for recovery as stranded costs of future fossil decommissioning expenses, because the costs failed to satisfy the "known and measurable" requirement under the stranded cost definition and because the costs would not be typically recoverable in a regulated environment. PECO Restructuring Order, slip op. at 91-92. The Commission relied on established precedent in denying PECO's claim. Id. (citing Penn Sheraton Hotel, Co. v. Pennsylvania Public Utility Commission, 198 Pa. Superior Ct. 618, 184 A.2d 324 (Pa. Super. 1962)). The Duquesne claim for recovery of future fossil decommissioning costs suffers from similar deficiencies. The recoverability of future fossil decommissioning costs must be addressed consistently by the Commission in order to implement transition in a manner fair to both utilities and ratepayers as is required under the Act. 66 Pa. C.S. §§ 2804(14) & 2802(8). As set forth below, DII advocates rejection of the DLC claim for future fossil decommissioning expenses.

2. Duquesne's Approach

Duquesne presents various approaches to stranded cost valuation in this proceeding. These approaches involve different methods and timing for determining the market value of its generating asset. Throughout the course of this proceeding, Duquesne proposed:

- to determine asset market value by an arbitration panel in 2003 (Duquesne Statement No. 1, pp. 14-16);
- to determine asset market value by a Commission ordered divestiture of up to 100% of its generating assets in 2003 (Duquesne Statement No. 1-R, pp. 11-13); and,
- to determine asset market value by a Commission ordered divestiture of up to 100% of its generating assets immediately (contingent on rejection of the proposed merger between Duquesne and Allegheny Power System) (Duquesne Statement No. 1-Rejoinder, pp. 1-2).

The Duquesne proposals that delay asset valuation past the start of direct access phase-in must be rejected. As explained in detail in Section IV.B.3.a, infra., acceptance of either of the Company's

delayed approaches prevents the Commission from quantifying DLC's net transition and stranded costs in this proceeding, which is inconsistent with the provisions of the Act, precedent established in the PECO restructuring proceeding, and the public interest.

Duquesne also presents an asset market valuation based on low and high market price ceilings. Duquesne Statement No. 3, pp. 25-37. In direct testimony, the Company relies on this range of values to establish that it will continue to have stranded costs at 2005. Id. In rebuttal testimony, the Company states that if the Commission rejects its new proposal to submit up to 100% of its generating assets to a Commission ordered divestiture in 2003, then the Company claims $1.9 billion in stranded costs based on the market price range provided in direct testimony. Duquesne Statement 3-R, p. 2. Finally, in rejoinder testimony, the Company states that it is willing to immediately divest itself of up to 100% of its generating assets, if the Commission cannot accept the Company's offer to auction its assets in 2003 because of the timing.[15] Duquesne Statement No. 1-Rejoinder, p. 1. Consequently, it is unclear whether the Company's proposal to rely on the range of market prices is still active in this proceeding. In any event, the Company's reliance on a range of asset market values does not meet the dictates of the Act. The range does not meet the burden of proving the existence and amount of this component of its stranded cost claim "based on substantial evidence in the record, that each request would recover the NPV of the unmitigated, net, known and measurable generation related expense within the definition of stranded costs." PECO Restructuring Order, slip op. at 68.

If the Commission is fully prepared in this proceeding to request an immediate auction of all of Duquesne's generating assets (as Duquesne has offered), this approach would satisfy the need for a definitive level of stranded costs as of the beginning of the transition period. However, many additional issues must be addressed associated with the immediate auction that may undercut the viability of this option. Those issues will be discussed further in Section IV.B.3.C, infra. Subject to resolution of those issues, DII supports valuation of DLC's assets based on an immediate auction of all of those generating assets.

Duquesne also requests recovery of $374.45 million (after tax) in stranded regulatory assets. Duquesne Statement No. 2-R, Exhibit No. DJC-10. As shown by DII, many of these claims are inappropriate under the Act and must be rejected. See DII Statement No. 3, pp. 6-30; DII Statement No. 3-S, pp. 6-23. Specific regulatory asset claims will be discussed in detail in Section IV.E, infra.

3. Intervenor Approaches

DII proposes to establish market value of Duquesne's generating assets based on a market price forecast and the asset value methodology of computing stranded costs. DII Statement No. 1, p. 29; DII Statement No. 2, pp. 9-48. The DII methodology predicts the revenues that a generating unit will be able to earn in the competitive environment. This methodology is a reasonable compromise of the competing interests and the only method contemplated by the Act.

Determination of stranded generation costs based on application of a market price forecast to the asset value methodology was used by the Commission to determine the known and measurable level of PECO's total stranded generation costs. PECO Restructuring Order, slip op. at 80-91. As explained below, this precedent, as well as other portions of the Act, requires a similar calculation based on the asset value methodology to be performed to establish Duquesne's stranded cost entitlement.

The DII proposal calculates a definitive level of stranded generation costs in this proceeding based on market price projection. DII Statement No. 1, p. 29. DII quantifies Duquesne's jurisdictional stranded generation costs at $994.969 million. DII Statement No. 1, p. 9, Exhibit SJB-2. In addition, DII recommends the use of an equity return disallowance to arrive at a level of just and reasonable stranded generation costs to be recovered from ratepayers. DII Statement No. 1, pp. 15-21. This results in a disallowance of $232.289 million of Duquesne's stranded costs. DII Statement No. 1, p. 9, Exhibit SJB-2. The total stranded generation costs to be recovered from ratepayers under the DII proposal is thus $712.68 million.[16]

In addition, DII recommends that Duquesne be permitted to recover $574.698 million

(jurisdictional pre tax) in stranded regulatory assets. Id. This recommendation is based on application of the aforementioned standards contained in the Act for properly claimed, quantified and recoverable regulatory assets. DII also recommends recovery of $9.791 in transition costs. Id. Finally, DII calculates the properly recoverable nuclear decommissioning expenses (net of trust fund earnings) of $42.920 million (jurisdictional). Id. In total, DII recommends that Duquesne be permitted to recover $1.39 billion in stranded costs from ratepayers. Id.

The DII recommendation without the equity return disallowance is depicted on the required tables submitted as Appendix A to this brief. The DII recommendation including the equity return disallowance is depicted on tables submitted as Appendix B. A comprehensive "Summary of Adjustments" is submitted as Appendix C.

4. Conclusion

The DII stranded cost recommendation properly applies the Act's standards for claimability quantified and recoverable stranded costs. DII's stranded cost recommendation is summarized in the chart below:

	Total Company as recommended by DII ($000)	**Total Jurisdictional (based on jurisdictional production factor of 99.909%) ($000)**
Stranded Plant	995,872	994,969
Less: Equity Return Disallowance	(232,500)	(232,289)
Other Regulatory Assets (Liabilities)	575,220	574,698
Transition Costs	9,800	9,791
Nuclear Decommissioning	42,959	42,920
Total Stranded Costs	**1,391,351**	**1,390,089**

When compared to the DII recommendation, the inadequacy of the Company's stranded cost proposal is evident. As opposed to establishing a definitive level of stranded plant, the Company proposes to

delay the determination of stranded plant until some time during the transition period. The remaining portions of the Company's claim are inflated and inappropriate for recovery as stranded costs. DII's analysis clearly fulfills the burden of proof placed on the Company with respect to the stranded cost determination in this proceeding. The DII analysis is clearly the most comprehensive and, thus, should be accepted by the Commission.

B. Generation-Related Stranded Costs (Recovery Pursuant to Section 2808(3))

1. Introduction

The largest category of stranded costs, "stranded generation costs," encompasses a broad spectrum of generation-related costs traditionally recoverable in the regulated environment, but may not be recoverable in the competitive market. 66 Pa. C.S. § 2803.[17]

Once it is determined which of the utility's claims properly qualify as potential stranded generation costs, the Commission must quantify the appropriate value of the Company's investment that is "stranded" because of transition to retail competition. Id.; PECO Restructuring Order, slip op. at 67-68 & 80-91. This must be done in accordance with the definition of "stranded cost" contained in the Act.[18] Id. As explained in detail infra, the only appropriate method to quantify the level of stranded generation costs is the "Asset Value Method," that compares Duquesne's net generating plant balance, as of December 31, 1998, to the market value of Duquesne's units in the competitive environment. See DII Statement No. 1, pp. 20-21; DII Statement No. 2, pp. 10-11. The Commission adopted the asset value method in determining the generation related stranded cost to be recovered by PECO . PECO Restructuring Order, slip op. at 80. The Commission must maintain consistency through the restructuring proceedings for all Pennsylvania utilities with respect to determining generation-related stranded costs each utility will recover during the transition period. See 66 Pa. C.S. § 2802(8).

After the amount of properly claimed and properly quantified stranded generation costs is determined, the Commission must establish a just and reasonable portion to be recovered from

ratepayers through the CTC. 66 Pa. C.S. § 2808(c)(3). With respect to properly claimed and quantified regulatory assets and NUG costs, the Act suggests that the "Commission shall allow recovery,"; however, the Act states that the "Commission shall determine the level of other generation-related transition or stranded costs that may be recovered through the competitive transition charge." Id. § 2808(c)(1), (2), & (3) (emphasis added). This section, along with the Commission's duty to ensure that the level of transition costs recovered from ratepayers is "just and reasonable" (Id. §§ 2804(13) & 1301) and "appropriate" (Id. § 2802(15)), mandates that the Commission use its regulatory discretion in setting the amount of properly claimed and quantified generation-related stranded costs to be recovered from ratepayers. See PECO Restructuring Order, slip op. at 93-101.

If stranded generation costs were to be treated the same as regulatory assets and NUG buyout costs, then the Legislature would have used the identical language to describe all three types of costs. Interpreting the Act as permitting a different treatment for the recovery of stranded generation costs is clearly the most reasonable. The Legislature's clear words on this issue cannot be ignored. 1 Pa. C.S.A. § 1921(b). The Commission need not allow recovery through the CTC of all properly claimed and quantified generation-related stranded costs. 66 Pa. C.S. §§ 2808(c), 2804(13), 2802(15) & 1301; DII Statement No.1, p. 14-21.

The appropriate mechanism for the Commission to effect the mandated balancing between the shareholder and ratepayer interests in setting just and reasonable recoverable levels of generation-related stranded costs is via an "equity return disallowance." The equity return disallowance compares the present value of revenue requirements associated with stranded generation costs (at a fully grossed up return level with a common equity return component) to a similar calculation without a common equity return component. DII Statement No. 1, p. 11. The equity return disallowance will be discussed in detail in Section IV.F, infra.

2. Net Book Value

(a) Total Net Book Value

For purposes of calculating Duquesne's generation-related stranded costs, DII uses Duquesne's quantification of its net generating plant and CWIP balance at December 31, 1998, of $979.130 million. DII Statement No. 1, p. 10; See Duquesne Statement No. 2-R, Exhibit No. DJC-21.

(b) Treatment of Beaver Valley 2 Lease Costs

A dispute exists in this proceeding as to how to properly treat the Beaver Valley 2 lease payments in calculating Duquesne's stranded cost. In its direct case, Duquesne includes the lease payments as part of its stranded generation asset claim and as a regulatory asset. See Duquesne Statement 2-R, Exhibit No. DJC-21, pp. 17 & 77. The Company inappropriately requests recovery for the Beaver Valley 2 lease expenses in two parts of its filing. First, the Company includes the lease expense as a "Non-Production Expense" in its calculation of stranded costs related to the Beaver Valley 2 unit. Duquesne Statement No. 2-R, Exhibit DJC-21, p. 17; DII Statement No. 3, p. 14. Duquesne also includes the NPV of the lease payments as a regulatory asset entitled "PV Beaver Valley Lease." Duquesne Statement No. 2-R, Exhibit DJC-21, p. 77; DII Statement No. 3, p. 14. Inclusion of the lease expense in two separate components of stranded cost claim violates the netting concept that is necessary according to the statutory definition of "stranded costs." See 66 Pa. C.S. § 2803; DII Statement No. 3, p. 14.

DII includes lease expense in the stranded generation cost calculation for the years 1999-2005 and as a regulatory asset for the remaining years of the lease. DII Statement No. 3, p. 14.

> DII witness Falkenberg has incorporated the full Beaver Valley lease expense for the years 1999-2005 in the DII quantification of generation stranded costs. I have included the remaining years costs in the net present value of the Beaver Valley 2 lease payments regulatory asset.

Id. Inclusion of the lease expense in the stranded generation cost claim decreases the market value of the Beaver Valley 2 unit and increases Duquesne's stranded cost associated with that unit. DII takes this

approach because it parallels the Company's approach in its original filing.

The Company, in its rebuttal case, modifies its stranded cost claim to remove the Beaver Valley lease regulatory asset, although this was not explicitly acknowledged by its witnesses in their testimony. Duquesne Statement No. 2-R, Exhibit No. DJC-10. Also, in its rebuttal filing, the Company includes the NPV of the 1999-2017 Beaver Valley 2 lease payments as an addition to the net book value of its generation assets. Id. DII does not conceptually disagree with the Company's approach as utilized in its Rebuttal Testimony because the double recovery issue is eliminated. The DII approach is an equally valid method to achieve the same result. DII recommends that the Commission endorse the DII treatment of the Beaver Valley 2 lease expense.

(c) Recovery of Phillips and Brunot Island Costs

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(d) Conclusion

DII accepts Duquesne's quantification of the net book value of its assets as of December 31, 1998. DII appropriately treats the 1999-2005 Beaver Valley 2 lease costs as a Non-Production Expense in the stranded generation cost calculation and the 2006-2017 costs as a regulatory asset. DII's use of the Company's net book value and the DII treatment of Beaver Valley 2 lease costs are both reasonable and should be accepted by the Commission.

3. Market Value

(a) Introduction

Duquesne proposes to delay market value determination of its generating units until some time during the transition period. Duquesne Statement No. 2, pp. 40-41; Duquesne Statement No. 2-R, pp. 3-4. This proposals is clearly inappropriate; the Commission is obligated (under the Act and relevant Commission precedent) to determine market value of Duquesne's generating units (and the correlating stranded cost total) as a part of this proceeding. DII offers a market value determination based on a

market price forecast. See DII Statement No. 1, pp. 9-10. DII's forecast, and the resulting stranded cost calculation, are reasonable and should be used by the Commission. Id. According to the DII calculations, Duquesne's stranded generation-related costs are $995.872 million. DII Statement No. 1, p. 48, Exhibit RJF-5a. $994.969 million of this stranded cost is jurisdictional. DII Statement No. 1, p. 9, Exhibit SJB-2.

Duquesne's proposal to delay determination of market value and total stranded cost is inappropriate. DII Statement No. 1, pp. 22-29. The Act clearly contemplates that a one-time determination of the electric utility's stranded cost will be made as part of consideration of Duquesne's restructuring proceeding.

The definition of "transition or stranded costs" contained in the Act supports a one-time determination of stranded cost responsibility.[19] Multiple parts of this definition dictate that the Commission must make a determination of the market value of Duquesne's generating assets and the correlating stranded cost total as part of the restructuring proceeding.

First, the definition requires generation-related costs to be netted in determining stranded costs. Id. It is impossible for the Commission in this proceeding to net Duquesne's potential stranded costs if one component of those stranded costs is not quantified.

Second, the definition establishes that a utility's stranded costs are to be determined "as part of its restructuring plan." Id. In 2003, the Commission will no longer be considering Duquesne's "restructuring plan." Rather, the Commission will be fulfilling its duties in the "oversight of the transition process." 66 Pa. C.S. § 2804. Stranded cost liability under the Act is intended to be determined as part of the Commission's duties during the first period, "as part of its restructuring plan," prior to the start of the transition process and direct access phase-in. Id. § 2803.

Third, the definition of stranded cost under the Act allows recovery for only those costs "which the Commission determines will remain following mitigation by the electric utility." Id. This definition

must be read in conjunction with the duties placed on electric utilities by the Act regarding mitigation. Electric utilities have the duty to mitigate generation-related stranded costs under the Act only during the transition period. Id. § 2808(c)(4).[20] The definition of stranded costs under the Act clearly contemplates a prospective evaluation of the electric utility's planned mitigation efforts during the transition period in determining the amount of stranded costs properly recoverable from ratepayers. An approach to generation asset valuation such as those offered by the Company in which determination of market stranded cost is not made until a point substantially into the transition period will clearly not allow the Commission to fulfill its duty to consider the valuation of future mitigation efforts in establishing a just and reasonable level of stranded costs to be recovered from ratepayers. Id.

The Act's "just and reasonable" recovery requirements also mandate that a definitive determination of total stranded costs be made as part of the Commission's decision in this restructuring proceeding. As previously explained, many provisions of Chapter 28 and the Public Utility Code, 66 Pa. C.S. § 101, et seq, mandate that the Commission's establishment of a CTC meet the just and reasonable requirements. 66 Pa. C.S. §§ 1301, 2804(13) & 2804(14). To delay the quantification of Duquesne's total stranded costs until sometime in the latter part of the transition period will not allow parties and the courts sufficient information to review whether the Commission's decision in this proceeding will produce just and reasonable rates.

> In addition, the Act also requires a yearly review of the Company's CTC revenues to:
>
> ... reconcile the annual revenues received from the charge with the annual amortization of transition or stranded costs approved by the commission under this section. The commission shall adjust the competitive transition charge based upon underrecovery or overrecovery of the annual amortization amount.

66 Pa. C.S. § 2808(f). The Commission stated: "Section 2808(f) requires annual reconciliation of CTC revenues in order to ensure that CTC revenues are no less nor greater than the authorized amount." PECO Restructuring Order, slip op. at 113. The Duquesne proposals to delay stranded generation cost determination will prevent the Commission from fulfilling its duty under Section 2808(f). In short, if

stranded costs are not determined in the instant proceeding, they cannot compare CTC revenues to "the annual amortization of transition or stranded costs approved by the Commission" under Section 2808.

Furthermore, the Commission's decision with respect to the PECO restructuring proceeding incorporates a one-time determination of stranded costs as of December 31, 1998, by comparing the net book value to the projected market value (based on a market price forecast). PECO Restructuring Order, slip. op. at 80-91. The Act mandates that the transition be accomplished in a manner that is fair to all ratepayers, utility investors, utilities, and competitors. 66 Pa. C.S. §§ 2802(8), 2804(7) & 2804(14). Fundamental fairness requires that an issue such as whether final determination of stranded costs can be delayed past the end of the restructuring plan litigation and customer choice phase-in must be decided on a state-wide basis. It is unfair for Duquesne's ratepayers to bear the heightened risk of stranded cost recovery that is associated with the Company's delayed valuation proposals. It is unfair for Duquesne's ratepayers to not have a definitive establishment of their total stranded cost and competitive transition charge responsibility before the start of direct access phase-in when PECO's ratepayers have such certainty. The balancing and fairness contemplated under the Act mandates that the Commission make a definitive determination of Duquesne's stranded cost as part of this proceeding.

In contrast to Duquesne's proposals to delay the stranded cost determination, DII offers a definitive calculation of the market value of Duquesne's generating units (and the correlating total stranded cost) as part of this proceeding. DII Statement No. 1, pp. 9-10 & DII Statement No. 2, pp. 1-48. DII uses the "asset value method" of determining stranded generation costs. The asset value method of stranded cost calculation is a most reasonable balancing of competing interests involved in this proceeding. See 66 Pa. C.S. § 2802(8). Adoption of the asset value method for calculation of Duquesne's stranded costs also will result in the consistency of approach necessary by the Commission throughout the state on this issue because the same approach was used in the PECO proceeding. PECO Restructuring Order, slip op. at 80.

The asset value method essentially determines the loss to Duquesne if it were to sell its generating assets at market price, without actually having the Company relinquish the assets and consummate a sale. DII Statement No. 2, pp. 10-11. The asset value method computes the "loss" experienced by shareholders because of movement to a competitive market by comparing a market value estimate of Duquesne's assets under competition to the present value of those assets contained on Duquesne's books. Id. at 20; DII Statement No. 1, p. 20.[21] The asset DII value method is a reasonable proxy for results obtained from a properly implemented divestiture.

The asset value method is fully consistent with the definition of stranded costs in Chapter 28. Duquesne shareholders will be appropriately compensated for any reductions in the value of the property supporting their investment. The difference between the book value of the assets and the revenue that the units will earn for the Duquesne shareholders in the competitive market is the "net generation-related cost" of the effect of restructuring on those generation assets. 66 Pa. C.S. § 2803. Under regulation, shareholders were given an opportunity to earn a just and reasonable return on the generation-related assets. Investors were guaranteed only a "return of" their investment; investors were not guaranteed a "return on" their investment. See e.g., Duquesne Light Company v. Barasch, 109 S.Ct. 609, 488 U.S. 299 (1989); Philadelphia Electric Company v. Pennsylvania Pub. Util. Comm'n, 61 Pa. Commw. 102, at 329, 433 A.2d at 623 (emphasizing that removal of units from rate base represented a denial of a return on investment but not a denial of a return of investment). Thus, the asset value method calculates stranded costs based on the return of the shareholders' investment and any diminution in the value of that asset caused by the transition to a deregulated market. This is precisely the type of balancing of shareholder and ratepayer interests that is contemplated under the Act. 66 Pa. C.S. §§ 2802(8) & 1301.

Furthermore, the PUC utilized the asset value method to determine the amount of stranded generation costs that PECO will be permitted to recover. PECO Restructuring Order, slip op. at 80. Chapter 28 mandates that the transition to a competitive market be accomplished in a manner that is fair

to all consumers, utilities and competitors. 66 Pa. C.S. §§ 2802(8) & 2804(14). Fairness demands that the asset value method be consistently applied in the valuation of stranded generation costs.

(b) Market Price Projections

In evaluating a market price forecast, three general elements should be considered. First, the forecasting methodology should be appropriate. Second, the inputs to the forecast must be reliable and accurate. Third, the results obtained from the forecast must be plausible. As explained below, the DII market price forecast satisfies all three criteria regarding its modeling of future market prices in the Duquesne service area. DII respectfully requests that its market price forecast be accepted by the Commission in establishing Duquesne's stranded generation cost.

(i) Forecasting Methodology

The first critical element of any market price analysis is the forecasting methodology. DII's market price projection uses a model referred as "the KPC Model". The KPC Model is appropriate because it is designed to predict prices in a competitive bid-based market, such as the market that Duquesne's generation assets will face during the transition period and beyond. The KPC Model contains two types of market price simulations: a probabilistic simulation and a "Monte Carlo" pumped storage simulation. DII Statement No. 2, pp. 35-39.[22] The KPC Model has been used in numerous regulatory proceedings throughout the country and has been successfully benchmarked against the utility company models in those proceedings. DII Statement No. 2, pp. 37-38, Exhibit No. RJF-2. The KPC Model is clearly suitable and appropriate to perform the market price analysis in this proceeding.

Duquesne does not criticize the KPC Model; rather, Duquesne professes a general aversion to all modeling. Duquesne Statement No. 3, pp. 7-16; Duquesne Statement No. 9-R, pp. 3-4. Although DII agrees with the Company that some uncertainty is inherent in forecasting market prices, that uncertainty is not sufficient to mandate rejection of the DII market price forecast in this proceeding. DII Statement No. 1, p. 26 & DII Statement No. 2, p. 13. Many aspects of this proceeding rely on

projections of costs or expenses. For example, Duquesne's nuclear decommissioning stranded cost claim relies on a projection of decommissioning expenses 30 years into the future. All market participants rely on projections that may not come to fruition. DII Statement No. 1, pp. 26-28. The balancing of interests necessary under the Act mandates that the Commission rely on the most reasonable projections to establish DLC's stranded cost entitlement. 66 Pa. C.S. § 2802(8). DII respectfully submits that the DII market price analysis is the most reasonable projection and should be accepted by the Commission.

(ii) Input Assumptions

The second criterion for determining whether a market price forecast is reliable is an examination of whether the input assumptions are independently derived and reasonable. The DII market price forecast relies on independent publicly available data sources such as information supplied to the Federal Energy Regulatory Commission ("FERC"), the North American Electric Reliability Council ("NERC") and the East Central Area Reliability Coordination Agreement ("ECAR"). See DII Statement No. 2, p. 41. The data is changed only where the original source is clearly wrong or inappropriate for the model. Id. at 34 & 42. DII discusses the major inputs to that forecast below (i.e., relevant market, fuel price projection, reserve margin, cost and efficiency of new generators). The DII inputs are reasonable and the resulting market price forecast should be accepted by the Commission.

The first input to be considered in performing a market price projection is the relevant market that the projection will model. DII models the ECAR market with consideration of imports and exports to that market. DII Statement No. 2, p. 15. ECAR is used because Duquesne currently participates in pool-wide relationships for reliability with the other ECAR members. OCA also models the ECAR market. OCA Statement No. 3, pp. 3-4. No substantial dispute exists in this proceeding as to whether ECAR is the correct market for modeling purposes.[23]

The second major input to the market price forecast is fuel price projections. DII relies on the

Energy Information Association ("EIA") fuel price forecast, which periodically releases projections for the escalation of coal, oil and natural gas prices. DII Statement No. 2, p. 20. These projections are needed to determine the expense that a generating unit will face for the fuel necessary to operate the unit. Duquesne agrees that DII's use of the EIA forecast is "reasonable." Duquesne Statement No. 9-R, p. 11.

Another critical input in a market price forecast is the assumption of any type of reserve margin on a market-wide basis. The reserve margin incorporated in the analysis triggers the addition of new generating capacity where demand for electricity begins approaching the maximum output of the units modeled. DII Statement No 2, p. 21. DII uses a 15% reserve margin adder to market prices to account for new capacity. Duquesne objects to this input stating: "It is inappropriate to force all suppliers to meet a 'one size fits all' reserve level, and it is incorrect to assume a planning reserve level in the development of market prices where no such reserve level is required by the region." Duquesne Statement No. 9-R, p. 3. Duquesne believes that the market will determine the appropriate reserve level in the future. Tr. at 914. Duquesne currently uses a 12% reserve in its integrated reserve planning and plans to maintain that level so customers will "enjoy traditionally high levels of service reliability." Duquesne Statement No. 9, p. 9. It is reasonable to expect that customers in the deregulated environment will desire the same level of reliability they now obtain from Duquesne as a regulated entity. Tr. at 919. Consequently, it is reasonable to assume that the market itself, as dictated by customers' desire for a continued higher level of reliability of electricity supply, will fall at an equilibrium based on a 15% reserve requirement. DII's use of a 15% reserve margin is clearly appropriate and should be endorsed by the Commission.

The final major input to the market price projection is the cost and efficiency of new generating capacity. As the demand for electricity approaches the maximum amount of electricity that current generators can supply, new units will be constructed. Consideration of anticipated capacity additions

is necessary because the cost and efficiency of those new units will affect future market prices. New units must sell electricity at prices sufficient to recover their average variable cost, which includes a contribution to the fixed cost associated with operating the unit. See DII Statement No. 2, p. 16. DII uses the following costs of new capacity: $595/kW combined cycle; and, $300/kW oil-fired CT. Id. at 25. These figures are consistent with assumptions used by other utilities in restructuring proceedings.[24] The efficiency of new units is indicated by the anticipated heat rate. DII uses a heat rate of 7,000 btu/kWh. Id. at 17. This is a reasonable assumption based on the most recently built generating units and the possibility of new environmental regulations, plant aging or effects of cycling that might degrade performance. Id. Duquesne's use of a 6365 to a 6625 btu/kWh for a combined cycle unit is overly optimistic and must be rejected. Id.

The inputs used in a market price simulation have a major effect on the results. The best sources of those inputs are unbiased reports submitted to organizations such as ECAR, NERC and FERC for purposes other than a market price projection. DII relies on these independent sources for the inputs used in its market price projection. As shown above, the DII inputs are reasonable, independent and verifiable. The market price projection based on those inputs should be accepted by the Commission.

(iii) Results

The third test of a model's performance in predicting market prices is whether the results obtained are plausible. The results of the DII analysis are indeed reasonable and should be accepted by the Commission.

The motivation for performing a market price forecast in this proceeding is establishing Duquesne's stranded generation costs.[25] In determining Duquesne's stranded generation cost, Duquesne acknowledges that the critical portion of the market price forecast is the post-2005 portion. Duquesne Statement No. 3-R, pp. 47-48. DII agrees that under the DII analysis, market prices during the transition period are irrelevant to determining the length of CTC collection. DII Statement No. 2-S, p. 4. The key

determinant is the post-2005 market price. Id.

Despite the Company's criticism of DII's market price forecast, DLC's own chart demonstrates that the DII market prices are at or below the Duquesne "Ceiling Low" market price range from 2006 on. Duquesne Statement No. 3-R, p. 20. The effect of DII's market prices, beyond the transition period, being at or below the low Duquesne market price scenario is to increase DII's recommendation for DLC's total stranded generation-related costs. Tr. at 45.

DII's results obtained from the KPC model are reasonable and reliable. The DII market prices are at or below the Company's "Ceiling Low" market price during the critical post-2005 period. The results are plausible and not biased. DII Statement No. 2-5, p. 5. DII respectfully requests that the results of the DII market price forecast be used to determine the market value of DLC's generation assets.

(c) Other Evidence of Market Value

The only major party proposing a different method to establish the market value of Duquesne's units is the Company itself. Duquesne advances three non-market price forecast methods for determining market value asset. All three methods have significant shortcomings, and as such, must be rejected.

Duquesne Method 1:

Duquesne's original proposal with respect to stranded cost valuation is to delay determination of total generation-related stranded costs until 2003. In 2003, an arbitration panel would examine market evidence and establish a value for the Duquesne generating units as of 2005. The Company would then examine the amount of competitive transition charges collected to that point of the transition period and determine how much more needed to be collected to compensate the Company for any additional portion of its "stranded cost." The CTC collection period would be lengthened or shortened accordingly. Duquesne Statement No. 2, pp. 40-41.

The Company's proposal to delay determination of stranded costs until 2003 is inconsistent with the Act and must be rejected. As explained in Section IV.B.3.a, supra, the definition of "stranded costs" clearly indicates a one-time determination of the Company's total stranded costs prior to the phase-in of direct access. Delaying stranded cost determination also does not satisfy the balancing of interests mandated under the Act. 66 Pa. C.S. § 2802(8).

> The Company's proposal is primarily one in which risks associated with stranded cost are shifted to the Company's customers and away from the Company's stockholders. Failing to fix a stranded cost recovery level at the beginning of the recovery period leads to substantial uncertainty on the part of the Company's customers, who will be facing unknown CTC charges in future transition period years, as well an uncertain length of time over which such charges will actually be collected. This would result, in my opinion, in an inappropriate regulatory framework for transitioning to retail competition. The DLC proposed framework is designed to provide the Company with a risk-free future with respect to stranded cost recovery while exposing its customers to the maximum risk associated with uncertainty regarding future market prices. This is clearly inappropriate and unfair to customers.

DII Statement No. 1, p. 24. Under the DLC proposal, the utility and shareholders are permitted to remain in the relatively safe position they have been in the regulated environment throughout the purported "transition period." It appears, under the DLC proposal, that the only parties subject to risks during the transition period are DLC's customers and competitors.

The uncertainty associated with the Company's proposal will hinder development of the competitive market. Until a precise and definitive level of stranded costs is determined and CTCs are established, customers will not be able to evaluate options in a competitive market. DII Statement No. 1, p. 24. Without a definitive determination, customers will not be able to evaluate whether to remain on the utility's rate cap service or to access the competitive market through an alternative supplier. Such uncertainty discourages competition in the Duquesne service territory in direct contravention of the goals of the Act. 66 Pa. C.S. §§ 2802(7), 2802(7), 2802(12), 2802(13) & 2804(14). In addition, this uncertainty will not be experienced by ratepayers in other parts of the state, such as PECO ratepayers. Such economic differential is inequitable, unfair and contravenes the stated objectives of the legislation.

Id. §§ 2802(8) & 2804(14).

Unless a definitive level of stranded costs is set prior to the beginning of the transition period, it will be impossible to know whether the CTC revenue being collected during the transition period will recover revenues in excess of the Company's actual and provable stranded cost. DII Statement No. 1, p. 23. The Commission cannot determine whether an over-recovery exists unless a definitive figure is established and CTC revenues projected that can be reconciled with the total figure. Id. In addition, the Commission cannot perform its duty under the Act to reconcile annual CTC revenues with "the annual amortization of transition on stranded costs approved by the Commission" and adjust the CTC based on "underrecovery or overrecovery of the annual amortization amount." 66 Pa. C.S. § 2808(f). It is inappropriate for the Commission to endorse a stranded cost valuation methodology, with such uncertainty as to possible stranded cost over-collection, to the detriment of ratepayers and competitors in the Duquesne service territory.

DLC's proposed use of an arbitration panel is also inappropriate. Duquesne terms the arbitration panel a "market-based approach." Duquesne Statement No. 3, p. 3. This categorization is a misnomer. As DII explains "the only true market-based approach would utilize an asset auction." DII Statement No. 2, p. 11. Duquesne instead proposes to have an arbitration panel sit as a supra-administrative body to make the stranded cost determination. Duquesne Statement No. 2, pp. 14-16. Parties could "provide market price data to the panel" (Duquesne Statement No. 2, p. 15); the arbitration panel would not be required, however, to provide any other type of participation in the process. See Id.; See also DII Statement No. 1, p. 25. Such proposal represents a significant deprivation of interested parties' rights to participate in a critical determination regarding the Act. Id. The minimal participation by interested parties under the DLC proposal is a stark contrast to the plentiful procedural due process rights to submit testimony, cross-examine witnesses, and submit briefs and exceptions accorded to participants in a full evidentiary hearing such as in this restructuring proceeding. Even if interested parties were accorded

participatory rights in connection with the panel's determination as set forth in the DLC proposal, the interested parties will be forced to go through the time and expense of relitigating the stranded cost issue. Such additional burden is unnecessary because, as explained supra, DII has presented a recommendation of DLC's stranded cost that can be reasonably relied upon by the Commission. DII Statement No. 1, pp. 9-13 and DII Statement No. 2, pp. 34-48.

The Duquesne proposal to determine stranded costs by an arbitration panel in 2003 must be rejected. The delay of the determination is inappropriate under the definition of "stranded cost" and does not result in the requisite balancing of interests during the transition to a competitive market. The use of an arbitration panel raises significant due process concerns for the interested parties. DII submits that the stranded cost determination must be performed in this proceeding and must be based on an objective source such as the DII market price forecast or an immediate divestiture of Duquesne's generation assets.

Duquesne Method 2:

As an alternative approach, the Company is willing to divest 100% of its generating assets in 2003 to establish market value asset. If the Commission does not order divestiture of any portion of the assets or if no bids are received, the market value and stranded costs associated with those assets will be determined by an arbitration panel.[26] Duquesne Statement No. 2-R, pp. 3-4.

This approach suffers from the same fatal flaws as the original Duquesne proposal. As previously explained, the Act clearly establishes that stranded cost liability must be determined as part of the restructuring proceeding, and, not delayed until some point during the transition period (such as a divestiture in 2003). 66 Pa. C.S. § 2803; Section IV. B. 1, supra. The continued uncertainty in this total stranded cost liability caused by the five year delay makes the Duquesne alternative approach unacceptable. DII Statement No. 1-S, p. 3. Although a properly conducted divestiture is the most accurate valuation of generating assets, a five-year delay undermines the interests of ratepayers and

shareholders.[27] DII Statement No. 1-S, p. 3. Moreover, the market price and stranded cost analysis presented by DII in this proceeding is an accurate proxy for divestiture results.

Duquesne Method 3:

In rejoinder testimony, Duquesne offers a third approach to the stranded cost valuation. Duquesne states that it is willing to immediately divest itself of all or any portion of its generating assets prior to the beginning of the phase-in of direct access. Duquesne Statement No. 1-Rejoinder, p. 1. An arbitration panel will value any assets receiving no bid or are not ordered, by the Commission, to be divested. Id. pp. 1-2. DII agrees that an immediate divestiture will establish an accurate valuation of the generating assets and, as proposed in the rejoinder testimony, establish customers' total stranded cost liability in a one-time determination as part of this proceeding. Id. Yet, the offer to immediately divest is contingent upon the merger between Allegheny Power System and Duquesne being rejected by any of the regulatory bodies whose approval is needed. Tr. at 24. In the event that the merger is approved by the Commission, Duquesne will establish future market value and stranded cost liability based on proposals set forth in that proceeding. Tr. at 25. Those procedures are not available for review and comment in this proceeding.[28]

If the Commission endorses Duquesne's third option, a full divestiture of all assets would need to occur. If the market value for any asset is determined by an arbitration panel, due process concerns raised supra will still apply. Consequently, in order for the immediate divestiture option to address all of DII's concerns, the Commission must be prepared to encourage an immediate, total and unconditional divestiture.

The Company also states that its willingness to submit to total divestiture is contingent on the Commission addressing "the generation rate cap issue." Duquesne Statement No. 1-Rejoinder, p. 2. Specifically, the Company requests a rate cap waiver. Tr. at 55. A waiver of ratepayers' statutory right to a rate cap for the period while Duquesne is collecting any stranded costs is unacceptable and blatantly

unlawful. Ratepayers have a non-bypassable obligation to compensate Duquesne for its qualifying stranded cost under the Act. 66 Pa. C.S. § 2808(a). As quid pro quo for this obligation, ratepayers are entitled to rate cap protection on the generation component of rates "for a period of nine years from the effective date of this chapter or until an electric distribution utility is no longer recovering its transition or stranded costs through a competitive transition charge . . . whichever is shorter." 66 Pa. C.S. § 2804(4)(ii). The Act requires that ratepayers compensate Duquesne for its qualifying stranded cost (which some ratepayers may not agree with) and the Act requires a rate cap on the generation component (which Duquesne does not agree with). Duquesne cannot re-draft the Act simply because it disagrees with the rate cap concept as set forth in the legislation. See Tr. at 127.

Duquesne's proposal to immediately divest all generating assets is acceptable to DII. The proposal appropriately balances the interests of shareholders, ratepayers and the Company. Absent full DLC divestiture, DII objects to DLC's third alternate proposal and respectfully requests that the Commission rely on the DII market price forecast and stranded cost calculations.

(d) Conclusions

DII presents the only accurate and reliable valuation of Duquesne's stranded generation costs in this proceeding. The DII analysis is based on the same methodology endorsed and adopted by the Commission in the PECO restructuring proceeding. DII's market price forecast is based on a model designed to simulate a competitive market, using reasonable inputs and obtaining plausible results. The DII analysis fairly balances the interests of all parties in making its recommendation.

Duquesne fails to offer any systematic and reliable valuation of its generating assets. DII submits that the Company fails to fulfill its burden of proof based on substantial evidence of the market value of its generating assets. Proposals to delay the valuation must be rejected as inappropriate under the Act and contrary to established Commission precedent. The Duquesne offer to immediately divest its generating assets is acceptable only if that divestiture is full. Anything less than full divestiture raises

significant due process concerns.

Based on the foregoing arguments, DII respectfully requests the Commission adopt the DII market value recommendation. Based on the DII analysis, Duquesne's units have a market value of negative $16.742 million. DII Statement No. 2, Exhibit No. RJF-5a. This amount represents the known and measurable value of DLC's generating units in the competitive market.

4. Other Factors Affecting Market Value/Stranded Costs

(a) Life Extension

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(b) Plant Shutdowns

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(c) Productivity Gains

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(d) Costs Independent of Operation

In its rebuttal case, the Company for the first time claims existence of "costs independent of operation." These costs purportedly reflect costs at units showing a negative margin under DLC's NPV analysis that will be "incurred whether or not that particular generating unit is operated." Duquesne Statement No. 3-R, p. 10. DII takes no position on the propriety of allowing the Company to recover these alleged costs independent of operation; yet, DII expresses the concern that such costs were not identified in the DLC direct case. DLC explains, on cross-examination, that costs independent of operation adjustment does not apply to the DII market price forecast and stranded generation calculation because those costs are somehow subsumed in the market prices assumed in the DII calculation. Tr. at 547-551. In other words, the DII market price analysis already accounts for this newly-discovered "deficiency" of other parties' market value calculation. Because the reputed costs independent of operation are already reflected in the DII market price forecast, acceptance of the DII market price

forecast and stranded cost calculation would not necessitate concurrent adjustments to that calculation for the DLC claim of "costs independent of operation."

(e) Projected Capital Additions and O&M Expense

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(f) Environmental Regulations

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(g) Other

DII is not addressing this issue but may respond, as appropriate, in reply brief.

5. Conclusion

DII presents the only accurate and reliable valuation of Duquesne's stranded generation costs in this proceeding. The DII analysis is based on the same methodology endorsed by the Commission in the PECO restructuring proceeding. DII's market price forecast is based on a model designed to simulate a competitive market, using reasonable inputs and obtaining plausible results. The DII analysis fairly balances the interests of all parties in making its recommendation that Duquesne's known and measurable stranded generation cost under the Act are $994.969 million (jurisdictional). DII Statement No. 1, Exhibit No. SJB-2.

Conversely, Duquesne fails to offer any systematic and reliable valuation of its generating assets. The Company fails to satisfy the burden of proof regarding its claim. The Company's multiple proposals that delay valuation must be rejected as inappropriate under the Act and contrary to established Commission precedent. The option to establish asset market value by an immediate divestiture is appropriate only if the Commission encourages a full and immediate divestiture. Moreover, Commission approval of the divestiture option cannot be connected with a waiver of the statutory generation rate cap.

In the event that the Commission is not prepared to encourage full and immediate divestiture in

accordance with the arguments raised above, DII respectfully submits that its market price analysis and stranded cost are accurate and appropriate, and as such, should be used in this proceeding.

C. Merger Savings

DII supports and adopts the OCA's position with respect to Duquesne's claimed savings that will result upon approval of the proposed merger. See OCA Statement No. 1, pp. 38-40. Fairness and equity require that those savings be credited against any stranded cost recovery authorized in this proceeding regardless of the valuation method used to determine the exact amount.

D. Decommissioning

1. Nuclear Decommissioning

The Act permits Duquesne to recover as a stranded cost "the unfunded portion of the utility's projected nuclear plant decommissioning costs." 66 Pa. C.S. § 2803. The Company's claim must meet the general standards for recoverability under definition of "stranded costs," including the requirement that the costs be determined on a NPV basis over the life of the asset. Id. In addition, nuclear decommissioning costs, similar to any other stranded cost, must be netted against any possible benefits of decommissioning that will occur in the future. Id.

Duquesne claims $281.0 million for nuclear decommissioning costs. Duquesne Statement No. 4, p. 8. DII submits that the DLC nuclear decommissioning claim is inflated because it is not valued on a NPV basis as of December 31, 1998. DII Statement No. 3, p. 31. In addition, the Company's claim is not a "net" cost because the claim fails to incorporate trust fund earnings on collected amounts. Id. To adjust for those flaws, DII recommends that the Commission accept $42.959 million as the NPV of stranded nuclear decommissioning costs at December 31, 1998. Id. at 33.[29]

Duquesne inappropriately quantifies its nuclear decommissioning costs as of December 31, 2005. The calculation of stranded costs contemplated under the Act requires establishment of a definitive level as of December 31, 1998. 66 Pa. C.S. § 2803. The Commission quantified PECO's

nuclear decommissioning costs as of December 31, 1998. PECO Restructuring Order, slip op. at 78. The phase-in of direct access begins on January 1, 1999. 66 Pa. C.S. § 2806(b)(1). The threshold date of December 31, 1998, is clearly the appropriate basis for calculating the NPV basis of stranded costs as defined in the Act. See Id. § 2803.

DLC's claim is further inflated because it fails to incorporate net trust fund earnings on amounts collected through 2005 or subsequent to 2005 under the Duquesne CTC proposal. DII Statement No. 3, pp. 31-32. Amounts collected from ratepayers to fund future nuclear decommissioning expenses are put into an external trust fund that earns a rate of return. This rate of return increases amounts in that trust fund. In order to meet the Act standard that stranded costs represents the net portion of generation-related costs, the calculation of Duquesne's nuclear decommissioning claim must recognize an offset for the trust fund earnings. 66 Pa. C.S. § 2803; PECO Restructuring Order, slip op. at 79; DII Statement No. 3, pp. 31-32.

In order to properly compute the total stranded decommissioning costs associated with Duquesne's nuclear facilities, DII utilizes the Company's decommissioning cost estimates, for each unit, in 1997 dollars. DII Statement No. 3, p. 32. Those cost estimates are then escalated to the year of retirement plus the number of years representing the midpoint between the retirement year and the end of the post-retirement disbursement by 2.5% annually. The calculation incorporates returns on the trust fund balances of 7.5% and assumes that the post-retirement returns on the trust fund balance continue through the same year used to escalate the cost estimate. The net future year deficiency for each unit is then discounted to December 31, 1998, utilizing the Company's after tax cost of capital. The results of this process are depicted in DII Exhibit LK-5. DII Statement No. 3, p. 32, Exhibit LK-5.

Based on this analysis, the properly quantified NPV of Duquesne's nuclear decommissioning expense is $42.959 million as of December 31, 1998. Id. at 33. Nuclear decommissioning costs are properly recoverable under the Act if the costs otherwise meet the definition of "stranded costs." This

definition requires that nuclear decommissioning costs be netted against any possible gains (such as earnings on the external trust fund) and stated on a NPV basis at December 31, 1998. 66 Pa. C.S. § 2803. Based on application of these principles, DII recommends DLC recover $42.959 million in nuclear decommissioning expense as part of its stranded cost claim. DII Statement No. 3, p. 33.

2. Fossil Decommissioning

Duquesne includes the projected costs of decommissioning fossil generation units as part of its generation stranded cost claim. Duquesne Statement No. 4, pp. 18-19. Future fossil decommission costs do not qualify as "stranded costs" under the Act. First, future fossil decommission costs are not recoverable under the applicable PUC and Pennsylvania appellate court precedent. Penn Sheraton Hotel v. Pennsylvania Public Utility Commission, 198 Pa. Superior 618 (1962); PECO Restructuring Order, slip. op. at 91-92. Second, the amount of such decommissioning cost is speculative at this point and does not satisfy the Act's requirement that any stranded generation costs be "known and measurable." Id.

Commission allowance of Duquesne's claim for fossil decommissioning cost would be contrary to the long established precedent of the Pennsylvania appellate courts and the Commission that such costs are not recoverable until they have been actually incurred. In Penn Sheraton, the Superior Court held that a prospective loss in excess of the salvage value of the property that a utility may incur upon the retirement of that property in order to remove the property was not properly recoverable in a utility's rate base. Penn Sheraton, 198 Pa. Superior at 623. The court based its decision on the uncertainty associated with prospective negative salvage because the known and measurable cost had not been incurred at the time of the proceeding. Id. at 625-26. The same uncertainty exists with Duquesne's future fossil decommissioning claim in this proceeding. See DII Statement No. 3, pp. 26-28.

The Commission consistently adheres to this precedent with respect to future fossil plant decommissioning. For example, in 1980, the Commission rejected an attempt by West Penn Power to

include in its rates an annual expense of $124,000 for prospective negative net salvage with regard to the retirement of fossil fuel plants. Pennsylvania Public Utility Commission v. West Penn Power Company, Docket No. R-80021082, Opinion and Order entered on January 30, 1981, 54 Pa. P.U.C. 602, 629 (1981).

The Commission also rejected recovery for prospective fossil decommissioning as a stranded cost pursuant to Chapter 28.[30] PECO Restructuring Order, slip op. at 92. As DII explains, the completely speculative nature of Duquesne's claim for future fossil decommissioning mandates rejection. DII Statement No. 3, pp. 26-28.

Future fossil decommissioning expenses are not recoverable as stranded costs under the Act. The costs are not recoverable under traditional ratemaking. The costs are not "known and measurable." Consequently, DII requests the Commission reject DLC's claim for future fossil decommissioning expenses.

E. Regulatory Assets and Liabilities

1. Introduction

The second category of stranded costs for which DLC may seek recovery through the CTC is "regulatory assets and liabilities."[31] 66 Pa. C.S. § 2803. In order to be claimable as stranded costs, regulatory assets must be "known and measurable" and traditionally recoverable under current regulatory practice but not recoverable in the competitive market. Id.

The Commission must quantify the amount of any properly claimed stranded regulatory assets. The Act requires that valuation of stranded regulatory assets be on a NPV basis. Id. In addition, regulatory assets must be "net electric generation-related costs" stranded by the transition. This netting concept contains two components. First, any costs claimed as stranded regulatory assets cannot also be recovered in any other part of DLC's restructuring filing (e.g., as a stranded generation cost or as part of other regulated rates). Id. Second, any costs claimed as stranded regulatory assets must be netted

against any regulatory liabilities.

It is inequitable and violative of Chapter 28 (as well as the "just and reasonable" requirement of Section 1301) to include regulatory assets in CTC stranded cost computation that are not net costs. Id. §§ 1301, 2804(13) & 2804(14). The objective of the statute with regard to transitional issues and stranded cost recovery is to ensure that neither the Company nor ratepayers are unjustly harmed. Id. § 2804(8). Ensuring that stranded regulatory assets are net costs is necessary to fulfill this objective.

Duquesne claims total stranded regulatory assets of $374.45 million at December 31, 1998. Duquesne Statement No. 2-R, Exhibit No. DJC-10. This figure is an after tax amount. DII calculates DLC's stranded regulatory assets on a pre-tax basis. See DII Statement No. 2 pp. 6-25. Based on the pre-tax figures in DLC Exhibit No. DJC-15, DII calculates Duquesne's regulatory asset claim to be $489.82 million on a pre-tax basis. See Appendix A, Table 4, infra.

As shown on Table 4 in Appendix A, DII proposes adjustments to the following Company claims: SFAS 109 Plant/ Deferred Taxes, Unamortized Debt Costs, Unamortized Sale/Leaseback Premium, Deferred Rate Synchronization Costs, Deferred Employee Costs, Deferred Coal Costs, Deferred Caretaker Costs, Pre-Accrual of Nuclear Outages, and SFAS 106 Deferred Costs.[32] DII also adjusts the Company's claim for transition costs. The specific basis for DII's adjustment to each claim is addressed below.

2. Disputes Regarding Specific Claims

(a) SFAS 109 Deferred Taxes

In its direct case, Duquesne reclassifies the FAS 109 related asset for Perry and Beaver Valley 1 from "plant in service" to a regulatory asset. Duquesne Statement No. 2-R, Exhibit No. DJC-21, p. 78. This regulatory asset is valued by Duquesne at $62.940 million at December 31, 1998. Duquesne Statement No. 2-R, Exhibit No. DJC-21, p. 78.

The SFAS 109 net plant regulatory asset is not properly claimable by Duquesne as a stranded

regulatory asset. The claimed regulatory asset is not a "net electric generation-related" cost pursuant to the Act. See 66 Pa. C.S. § 2803. Prior to claiming the regulatory asset, SFAS 109 net plant was included as "plant in service" for the Perry and Beaver Valley 1 units. DII Statement No. 3, p. 10. Inclusion of the SFAS 109 asset increases the net book value of the units. All else being equal, an increase in the net book value of any of Duquesne's generating assets increases the potential stranded generation costs associated with that asset.

After creating the regulatory asset, the Company should eliminate the SFAS 109 asset from its net book value amounts. DII Statement No. 3, pp. 10-11. In its direct case the Company fails to do so. The Company's exhibit supporting its regulatory asset claims states: "FAS 109 allocated to plant is reflected in the generating plant balance through 12/31/98." Duquesne Statement No. 2-R, Exhibit No. DJC-21, p. 78 n. 5. Thus, Duquesne requests double recovery for the asset amount. DII Statement No. 3, p. 10-11. Recovery for these costs is included elsewhere in the Duquesne stranded cost quantification as an increase in the stranded generation cost claim; consequently the claimed asset is not a "net" cost.

In its rebuttal case, the Company acknowledges DII criticism regarding the SFAS 109 regulatory asset, but neither explains the apparent double recovery, nor offers to rectify the double recovery. See Duquesne Statement No. 2-R, pp. 19-22. Although the Company offers no testimony regarding the proper solution to the FAS 109 plant double recovery, it appears the Company is adjusting its regulatory asset claim to remove the FAS 109 net plant asset. Specifically, the Company's Exhibit No. DJC-10 states the claim for "SFAS 109 Plant" as "0.00" and notes that the FAS 109 related asset is "included in plant as of 12/31/98." Duquesne Statement No. 2-R, Exhibit No. DJC-10. DII agrees that this represents the proper resolution of the "double recovery" problem.

> DII witness Mr. Falkenberg has included the FAS 109 asset in the December 31, 1998 net book value utilized in the DII quantification of generation stranded costs. I have eliminated the FAS 109 asset from the Company's claimed regulatory assets. Thus, DII has included the FAS 109 asset only once in its quantifications of stranded costs.

DII Statement No. 3, p. 11. DII's method is preferable because it represents the status quo as of the

effective date of the Act with regard to these costs. The DII stranded cost recommendation continues to include FAS 109 assets in the 1998 net book value for Duquesne's generating assets. Id.

Because the Company's request for inclusion in its stranded cost calculation of an SFAS 109 plant regulatory asset would lead to double recovery of those costs as both a regulatory asset and *stranded generation cost, the SAS 109 plant regulatory asset is not a "net" stranded cost under the Act.* DII submits that SFAS 109 net plant should remain part of the net book value of the Perry and Beaver Valley 1 generating units and that Duquesne's claimed regulatory asset of $62.90 million be denied.

(b) Unamortized Debt Costs

Duquesne seeks recovery as a regulatory asset for unamortized debt costs. Duquesne Statement No. 4, p. 9. The Company quantifies this regulatory asset at $28.84 million at December 31, 1998 on an after tax basis. Duquesne Statement No. 2-R, Exhibit No. DJC-10. On a pre-tax basis, DII recalculates the Company's claim as $50.980 million as of December 31, 1998. DII Statement No. 3, p. 11; See Duquesne Statement No. 2-R, Exhibit No. DJC-15. DII's claim must be denied because it fails to meet the definition of stranded costs under the Act. 66 Pa. C.S. § 2803. The Company has included in its stranded cost claim double recovery of these unamortized debt costs. Consequently, unamortized debt costs are not properly claimable by Duquesne as a regulatory asset in this proceeding and DII's proposal for recovery must be rejected.

The Company's claim for unamortized debt costs has two components. First, the claim contains the unamortized premium on reacquired debt. Duquesne Statement No. 4, p. 9. Second, the unamortized debt costs regulatory asset contains a claim for debt issuance expense. Id. at 9-10. Both elements of the proposed regulatory asset are currently recovered as costs of debt. DII Statement No. 3, p. 12. The inclusion of these costs reduces debt capitalization, which in turn increases Duquesne's cost of debt. Id.

Duquesne's recovery of these costs as a regulatory asset must be denied because these costs are

not "net electric generation-related costs" pursuant to the definition of stranded costs in the Act. 66 Pa. C.S. § 2803. The unamortized debt costs are currently included in the Company's cost of debt. DII Statement No. 3, p. 12.

> The unamortized losses, debt discount, and issuance expenses are utilized to reduce the debt capitalization component and the amortization of these amounts are included in interest expense, both of which serve to increase the cost of debt and provide for the full recovery of and on these costs.

Id. Despite requesting recovery of these costs as regulatory assets, the Company has not reduced its cost of debt in this filing to remove the costs and reflect recognition of the regulatory asset. Id.

Continued inclusion of these unamortized debts costs increases Duquesne's cost of debt. The Company's cost of debt is used in this proceeding to discount projected contribution margins after 2005 in determining stranded generation cost recovery. DII Statement No. 3-S, p. 6. Continued inclusion in the cost of debt thus increases generation-related stranded costs by reducing the NPV of future contribution margins. DII Statement No. 3, p. 13. This increase in generation-related stranded costs fully compensates the Company for costs represented by this alleged regulatory asset; separate recovery of these costs as a regulatory asset is unnecessary, unwarranted, and contrary to the Act.

The Company admits that inclusion of these costs as a regulatory asset and in its cost of debt conceptually represents double cost recovery. Duquesne Statement No. 2-R, p. 23. The Company claims, however, that the double recovery is irrelevant, if its proposal to value stranded generation costs as of 2005 is accepted by the Commission, because stranded costs will be determined using the Company's cost of debt at 2005.[33] Id.

The Company's supporting arguments are inapt and incorrect. As DII and other parties have shown, the Act intends for stranded costs to be determined at a one-time proceeding and valued at December 31, 1998; the Company's proposed delay in the valuation of stranded generation costs is inappropriate. See DII Statement No. 1, pp. 23-28; OCA Statement No. 1, pp. 4-7. The Company is incorrect that a delay in the valuation of generation-related stranded costs will eliminate the possibility

of double recovery. The choice of methodology for a stranded cost valuation in 2005, if one is to occur, could still result in a double recovery of these costs. DII Statement No. 3-S, p. 9. If the market valuation in 2005 relies on discounted future revenue or income streams, the only way to prevent double recovery would be to ensure that the discount rate used for that calculation exclude interest expenses associated with the unamortized debt cost. Id. Delaying uncertainty regarding the potential for double recovery is unnecessary because evidence exists in this proceeding to require that such costs be excluded from the discount rate so as to assure the non-existence of double recovery if the Company's proposed regulatory asset is accepted. See DII Statement No. 3, pp. 11-13; DII Statement No. 3-5, pp. 6-10.

Duquesne's regulatory asset claims for unamortized debt costs is inappropriate under the Act. Duquesne fails to remove unamortized debt costs from its cost of debt. Because that unadjusted cost of debt is used to quantify the Company's stranded generation costs, recovery of the unamortized debt costs as a regulatory asset will violate the netting concept in the definition of stranded costs. 66 Pa. C.S. § 2803. Duquesne will be adequately compensated for unamortized debt costs in its stranded generation cost claim; consequently, the unamortized debt costs are not properly claimable by Duquesne as regulatory assets under the Act. DII recommends that Duquesne's proposed regulatory asset of $50.980 million be denied.

(c) Unamortized Sale/Leaseback Premiums

In its direct case, Duquesne claims as a regulatory asset full recovery for the "premium on reacquired debt associated with Beaver Valley No. 2." Duquesne Statement No. 4, p. 10. DLC values the regulatory asset at $30.06 million. Duquesne Statement No. 2-R, Exhibit No. DJC-21, p. 77. This regulatory asset claim is improper under the Act because recovery for these costs is included elsewhere in the DII restructuring filing. 66 Pa. C.S. § 2803.

The claimed regulatory asset must be considered in two parts--pre-2005 and post-2005.

> [T]hrough 2005, the Company includes the unamortized BV2 sale/leaseback refinancing premium as a separately identified regulatory asset and also as an increase to stranded

> generation costs. After 2005, the Company includes the remaining BV2 sale/leaseback refinancing premium as a separately identified regulatory asset and also that amount in the BV2 lease payments regulatory asset. Thus, the Company has requested recovery of the same BV2 sale/leaseback refinancing premiums twice.

DII Statement No. 3-S, p. 6. The sale/leaseback premium is included in the stranded generation cost claim because full lease expense and the premium is included through the year 2005 as Beaver Valley 2 "Non-Production Expense." Duquesne Statement No. 3, Exhibit No. DJC-21, p. 17. Because the pre-2005 sale/leaseback refinancing premium is included as an increase to stranded-generation costs, it is not properly claimable as an additional separate regulatory asset under the Act; the refinancing premium is not a "net" electric generation related cost under the Act. See 66 Pa. C.S. § 2803.

Post-2005, the Company requests recovery for the remaining Beaver Valley 2 sale/leaseback refinancing premium as a regulatory asset and recovery of a separate Beaver Valley 2 lease payments regulatory asset. Duquesne Statement No. 2-R, Exhibit No. DJC-21, p. 77. The Company's calculation of the lease payments regulatory asset includes the refinancing premium. DII Statement No. 3-S, p. 6. This obvious request for double recovery of the post-2005 refinancing premium must be rejected. 66 Pa. C.S. § 2803.

The correct treatment of the refinancing premium is to include the full value of the Beaver Valley 2 lease expense for the years 1999 through 2005 in the quantification of generation stranded costs. DII Statement No. 3, p. 14. The post-2005 sale/leaseback refinancing premium costs should be recovered through the Beaver Valley 2 lease payments regulatory asset. Id. The DII proposal is equitable and eliminates double recovery for the refinancing premium.

Although DLC does not address DII's criticisms during the discussion of this regulatory asset in its rebuttal case (See Duquesne Statement No. 2-R, p. 24), it appears the Company is modifying its stranded cost claim to remove the double recovery. Specifically, Exhibit No. DJC-10 notes that the present value of the Beaver Valley 2 lease expense including "premiums and unamortized debt costs" is included as "generating plant." Duquesne Statement No. 2-R, Exhibit No. DJC-10 n. 1. The exhibit

omits the originally claimed "PV Beaver Valley Lease" regulatory asset, which was valued by DLC at $227.78 million, and the "BV2 Sale/Leaseback Premium" regulatory asset, valued at $30.06 million. Id. & Exhibit No. DJC-21, p. 78.

The DLC exhibit also "adjusts" the DII claim to eliminate the $227.78 million Beaver Valley 2 lease expense regulatory asset that DII recommends DLC be entitled to recover. Id. As previously explained regarding the treatment of the lease expense for calculation of net book value, DII continues to recommend that the lease expense for 1999-2005 be treated as part of stranded generating costs and the lease expense post-2006 be treated as a separately identified regulatory asset valued at $227.78 million. DII Statement No. 3, p. 14. Ironically, this results in DII recommending a higher level of total stranded regulatory asset recovery for DLC than the Company's claim as represented in its rebuttal case.

DII respectfully requests that its treatment of the Beaver Valley 2 sale/leaseback premium be adopted and that the Company's claimed BV2 sale/leaseback regulatory asset of $30.06 million be denied. Because recovery for the refinancing premium will be provided from elsewhere both pre-2005 and post-2005, Duquesne's claimed regulatory asset for the Beaver Valley 2 sale/leaseback premium is not a "net" stranded regulatory asset pursuant to the Act. Recovery should be denied.

(d) Deferred Rate Synchronization Costs

In its direct case, Duquesne proposes to recover as a regulatory asset $33.43 million (at December 31, 1998) for "deferred rate synchronization costs." Duquesne Statement No. 2-R, Exhibit No. DJC-21, pp. 77 & 78 DII submits the Company's requested recovery as a regulatory asset of deferred rate synchronization costs is overstated and improper under the Act because it is not stated on a NPV basis. DII Statement No. 3, p. 23.

Deferred rate synchronization costs are early window costs associated with Perry and Beaver Valley 2 that the Company was permitted to amortize through 2006 as part of the Fort Martin settlement. Id. The Commission Order authorizing recovery of these deferred early window costs did not permit

the Company to claim a return on the unamortized deferred rate synchronization costs. Id. In other words, in the regulated environment, a return would not be recoverable. See 66 Pa. C.S. § 2803. Consequently, the deferred rate synchronization regulatory asset in this proceeding must be quantified at the NPV of the future eight years of amortizations without a return on the costs. Id. This means that the amortization must be at the Company's after-tax discount rate, which results in a recovery of $24.87 million (as of December 31, 1998) instead of the Company's claim of $33.43 million. DII Statement No. 3, p. 23, Exhibit No. LK-4.

With respect to DII's criticism of this regulatory asset quantification, Duquesne admits that it has mis-quantified the amount that should be included in the regulatory asset claim and decreases its claim by $0.5 million. Duquesne Statement No. 2-R, p. 25. This adjustment, however, is based on a purported difference in the amortization period for these costs and avoids DII's contention that the regulatory asset NPV must be discounted to reflect the Commission's disallowance of return on the deferred amounts. DII Statement No. 3-S, p. 23.[34] The Company's stranded cost claim consequently remains overstated at the nominal value and must be restated to the present value without a return in order to be properly quantified pursuant to the dictates of the Act. Id.

Duquesne does not appropriately quantify its claim for the deferred rate synchronization cost regulatory asset. This claim must not include a return on the amortization because return was not authorized by the Commission in the Order permitting recovery. DII requests the Commission reject the DLC proposal and authorize DLC recovery for a regulatory asset associated with deferred rate synchronization costs of $24.870 million.

(e) Deferred Employee Costs

The Company claims a regulatory asset for deferred employee costs valued at $17.800 million at December 31, 1998. Duquesne Statement No. 2-R, Exhibit No. DJC-21, p. 77 and Exhibit No. DJC-10. This claim encompasses deferred compensated absences and deferred injuries and damages.[35]

Neither component of the deferred employee cost claim is properly recoverable under the Act as a stranded regulatory asset. Moreover, recovery for deferred employee costs is provided elsewhere in the Company's stranded cost claim and recognition of the regulatory asset would lead to a double recovery in violation of the netting concept in the Act's definition of "stranded costs." 66 Pa. C.S. § 2803; DII Statement No. 3, p. 17. Consequently, the Duquesne claim for regulatory assets must be denied.

The Company's claimed stranded regulatory asset for deferred employee costs is inappropriate and must be rejected. First, deferrals created by the accrual accounting being higher than the cash accounting for these regulatory assets will reverse in the future. DII Statement No. 3, p. 17. This means that at some point in the future, even if it is in the last year of the asset's life, a reversal should occur that will allow the Company to collect these costs on a cash basis that is higher than the accrual basis. DII Statement No. 3-S, p. 16. The over-collection should be equal to the regulatory asset claim. Because the Company will be compensated for the regulatory assets at that time, recognition and recovery of a stranded regulatory asset in this proceeding is inappropriate; the regulatory asset is not stranded by the movement to a deregulated environment. 66 Pa. C.S. § 2803.

Second, the Company requests double recovery for these costs because the costs on an accrual basis have been inflated each year into the future and included as part of the Company's stranded generation cost quantification. DII Statement No. 3, p. 18; DII Statement No. 3-S, p. 15.

> [T]he Company's generation stranded costs are predicted upon projections of expenses that are based upon the accrual levels of injuries and damages and compensated absences inflated each year into the future. Under the Company's generation stranded cost approach, it presumably will collect more each year for injuries and damages and compensated absences than it will pay out, which is reflected in a lower market value and higher generation stranded costs. The Company failed to provide a return benefit to ratepayers on the amounts collected in excess of cash payments in each of those future years. Thus, the Company's approach results in improper and excessive recovery through excessive generation stranded costs, an issue which DII has not otherwise addressed but which bears directly on the Company's request for these employee costs as a regulatory asset.

Id. The Company's rebuttal case fails to address, let alone rebut, the existence of this double recovery

as both a regulatory asset and an addition to stranded generation costs. See Duquesne Statement No. 2-R, p. 26.

DII submits that the Company has inappropriately claimed a regulatory asset of $17.8 million in deferred employee costs. The accounting treatment of these costs will reverse in the future. DII Statement No. 3,, p. 17. Thus, the Company will fully recover the costs in the competitive environment and the deferred employee costs are not "stranded" by the transition to the competitive market. 66 Pa. C.S. § 2803. In addition, the Company's stranded generation cost claim includes these costs. Recovery of deferred employee costs as a separate regulatory asset will violate the netting necessary under the definition of stranded costs. Id. For these reasons, DII recommends that the Commission deny Duquesne's request to recover $17.8 million in deferred employee costs. The Company's claimed regulatory asset for deferred employee costs is inappropriate for reasons stated above and must be rejected.

(f) Deferred Coal Costs

The Company claims recovery as a regulatory asset for $13.5 million in deferred coal costs. Duquesne Statement No. 2-R, Exhibit No. DJC-10. This claim arises from a 1990 settlement at Docket Nos. P-890386 and P-890387. Duquesne Statement No. 4, p. 13. In that settlement, the PUC imposed a cap on fuel costs the Company could recover through the Energy Cost Rate because some of the claimed coal costs were above market price. DII Statement No. 3, pp. 18-19. As part of that settlement, Duquesne was granted the opportunity to recover the deferred amounts in the future, if the Company could show that the Company's coal costs in future years are below market value. Id. at 19.

Recovery by Duquesne for deferred coal costs as a stranded regulatory asset is inappropriate. First, pursuant to the Act, it is inappropriate to allow stranded cost recovery for costs deemed, in the past, to be excessive and non-recoverable. 66 Pa. C.S. § 2803; DII Statement No. 3, p. 19. "Any amounts previously disallowed by the Commission as imprudently incurred" are specifically excluded

from the definition of "stranded or transition costs." 66 Pa. C.S. § 2803. To allow the Company to recover deferred coal costs as a regulatory asset would, in effect, reinsert these coal costs into the rates being charged to Duquesne's customers. Because these amounts were previously disallowed, recovery of this regulatory asset would circumvent the generation rate cap as set forth in Section 2804. 66 Pa. C.S. § 2804(4).

Second, the Company has not demonstrated that the specific coal costs would be typically recoverable in a regulated environment. See 66 Pa. C.S. § 2803. As part of the 1990 settlement, the Company was permitted future recovery of the deferred coal costs if it could show that its coal costs were below market in future years. DII Statement No. 3, pp. 18-19. Thus, under the traditional regulatory environment, in order to include the deferred coal costs and rates, Duquesne would have to produce evidence that its future coal costs are or will be below market. Id. The Company has produced no such evidence that its future coal costs will be below market. Id. at 20. The fact that the coal costs contained in its filing will decline in 2000 is irrelevant because the Company has not demonstrated that the declining coal costs will be below market. DII Statement No. 3-S, p. 18. Under the traditional regulatory environment, the coal costs would be recoverable only if the Company met the conditions of the settlement. The Act, in no uncertain terms, does not override this recovery requirement.

The Company's claim for regulatory asset representing deferred coal costs is inappropriate under the Act because these amounts were previously disallowed as being uneconomic and because the amounts would not be typically recoverable in the regulated environment based on the evidentiary record created by Duquesne in this proceeding. Consequently, DII submits that recovery for the deferred coal costs regulatory asset must be denied.

(g) Deferred Caretaker Costs

Duquesne claims recovery for a $3.92 million regulatory asset for deferred caretaker costs. Duquesne Statement No. 2-R, Exhibit No. DJC-10. On a pre-tax basis, the claim is $6.77 million. Id.

Exhibit No. DJC-15, p. 4. These costs do not meet the standards for recovery of stranded costs pursuant to the Act. 66 Pa. C.S. § 2803; DII Statement No. 3, p. 20. Consequently, DII's proposed recovery for the regulatory asset claim must be denied.

The deferred caretaker cost regulatory asset reflects the accounting treatment authorized by the Commission at Docket No. P-900485 for preservation costs associated with maintaining the Philips and Brunot Island generating plants. Duquesne Statement No. 4, p. 14. Duquesne has repeatedly stated that it has no intention to return these units to commercial operations. Duquesne Statement No. 2-R, pp. 32-35.

Because these units will not be returned to commercial operation, recovery of the regulatory asset is inappropriate under the standards set forth in the Act. Regulatory assets are recoverable under the Act only if they would be typically recoverable in the regulated environment. 66 Pa. C.S. § 2803. Duquesne was not guaranteed recovery of these costs; Duquesne was guaranteed only a right to seek recovery, if and only if, it met standards for recovery under the settlement, which requires return of the unites to commercial operation.. This it cannot do. DII Statement No. 3, p. 20.

Duquesne's explanation of its efforts to return the units to commercial service is irrelevant. (Duquesne Statement No. 2-R, pp. 32-33). DLC has not met the threshold requirements of returning the units to commercial service, in order for the costs to be recoverable in the traditional regulatory environment or under the Act. 66 Pa. C.S. § 2803. Moreover, the Company has made no showing that if the units were returned to service, those units would not recover the deferred caretaker costs through commercial operation in the competitive environment. DII Statement No. 3, p. 21. In other words, the Company has failed to satisfy the burden of proving that these costs have been "stranded" by the transition to a competitive environment. 66 Pa. C.S. § 2803. Consequently, DII submits that DLC recovery of these costs, as a regulatory asset must, be denied.

(h) Pre-Accrual of Nuclear Outages

Duquesne claims, as a regulatory asset, $13.50 million in "Pre-Accrued Nuclear Outages" resulting from a unilateral accounting change for nuclear outage costs. Duquesne Statement No. 2-R, Exhibit No. DJC-10; Duquesne Statement No. 2-R, p. 29.[36] On a pre-tax basis, the Company's claim is $22.65 million. Duquesne Statement No. 2-R. Recognition of this regulatory asset in the Duquesne stranded cost calculation is inappropriate because the pre-accrual will reverse in the last year of the life of the assets. DII Statement No. 3, p. 16. In the last year, the pre-accrual is reversed, but no additional deferrals are made. DII Statement No. 3-S, p. 12. In short, the Company will be made whole for the deferral in the last year of the asset life; as such, no "stranded" cost is created by the transition to the competitive market. Id. at 13. The claimed regulatory asset is not stranded because DLC will recover the deferral amount regardless of the transition to the competitive market. Consequently, pre-accrued nuclear outage costs are not properly recoverable as a stranded cost pursuant to Chapter 28.

Because this simply represents accounting changes (i.e., no actual money changes hands), no carrying charge associated with the change exists. Id. at 12. The difference is solely a timing difference and not a permanent difference as the Company has treated it by requesting recovery of the "stranded" regulatory asset. Id. No part of the deferral is made unrecoverable because of the transition to a competitive market; consequently, the deferral is not "stranded" pursuant to the definition in Chapter 28. 66 Pa. C.S. § 2803.

The Company inappropriately requests recovery for a regulatory asset related to its change in the accounting treatment of costs associated with nuclear outages. As DII illustrates, these costs are not "stranded" pursuant to the Act because the accounting deferral will reverse in the final year of the nuclear unit's life. DII respectfully requests that the Commission deny recovery by Duquesne for its claim of $22.65 million in "Pre-Accrued Nuclear Costs."

(i) Transition Costs

The Company requests recovery of $10.59 million in transition costs as part of its stranded cost claim. Duquesne Statement No. 2-R, Exhibit DJC-10. On a pre-tax basis, the Company's claim is $18.1 million. Id. Exhibit No. DJC-15, p. 11. Although transition costs are properly recoverable under the Act, certain aspects of the Company's claim are invalid and directly conflict with other parts of its filing.

Specifically, the Company request for recovery, as a transition expense, for the CARS information processing and communications network system, should be denied.[37] Such costs should not be considered transition costs under the Act because Duquesne anticipated installing the CARS system prior to passage of the Act. Duquesne Statement No. 8, p. 5. In fact, in January 1996, 11 months prior to passage of Act 138, Duquesne entered into a 15 year agreement for the implementation and operation of the CARS system. DII Statement No. 3, p. 24. The system was already contemplated prior to the advent of competition and was not necessitated by the Commonwealth's introduction of competition in electricity generation supply. Consequently, such costs should not be recovered as transition costs under the Act. The necessary adjustment to transition costs remove CARS cost is $8.3 million, resulting in proposed recovery of $9.8 million for transition costs. Id. at 6 & 24.

Duquesne's treatment of the CARS system costs is also inconsistent in its filing. Duquesne claims that CARS implementation will not result in higher ratepayer costs because the "cost of the service agreement for each year and over the 15 year term were offset by cost reductions associated with base operations, customer choice, and proved reliability and enhanced based services." Duquesne Statement No. 8, pp. 7-8. The Company also states it incurred no capital costs associated with the system. Id. at 7. If the Company incurred no capital costs, and, costs associated with the service agreement will be offset by other savings, then the Company incurs no net costs associated with the system. It is inequitable and inconsistent with the Act to compensate the Company for "stranded" costs that in reality will be offset by other savings. 66 Pa. C.S. § 2803; DII Statement No. 3, p. 25.

In response to DII's criticisms, the Company claims that the CARS expenses are not included in the transition cost claim. Duquesne Statement No. 2-R, p. 30. Instead, the Company claims that the costs have been included as a distribution operating cost. The Company provides no support for this claim. In the event that cost recovery is included as a distribution operating cost, as opposed to a transition cost, these costs are still treated inconsistently in the filing and recovery should be denied. The Company cannot support implementation of the CARS system by stating that it imposes no cost on ratepayers and, simultaneously claim costs associated with the system should be recovered from ratepayers either as a regulatory asset or as a distribution cost.

The Company's claim for transition costs is overstated because it includes costs associated with the CARS communications network. This system is not properly categorized as a "transition" cost because it was contracted for prior to the advent of competition. In addition, Duquesne incurs no net costs associated with the CARS system. Consequently, DII submits no recovery of CARS costs is permissible. DII respectfully requests that $8.3 million in CARS related expense be removed from DLC's proposed transition cost claim.

(j) SFAS 106 Deferred Costs

The Company proposes recovery for SFAS 106 costs related to post-retirement benefits such as health care and life insurance. Duquesne Statement No. 4, p. 13. Duquesne quantifies this regulatory asset at $2.47 million. Duquesne Statement No. 2-R, Exhibit No. DJC-10. Because of the passage of the Act, Duquesne proposes to accelerate amortization of these costs over the seven-year transition period instead of the originally proposed twenty-year period. Id. at 14.

The Company's proposed recovery of this regulatory asset is clearly inappropriate and must be rejected. Because these costs are included on the Company's financial books on an accrual basis, instead of a cash pay-as-you-go basis, the Company currently over-collects SFAS 106 costs. This over-collection will continue into the foreseeable future. DII Statement No. 3, p. 21. This over-recovery

earns a return (either the Company's overall return, or, the rate of return for an external trust fun) for which only the Company benefits. Id. Ratepayers receive no advantage of this accounting recognition, because at the point that cash outlays for post-retirement benefits exceed the accrual amount as reflected on the Company's books, the unit will no longer be in regulated service. Id. at 21-22. It is, thus, inappropriate for the Company to claim a short-term "stranded cost" for this regulatory asset, when in reality, only the Company will realize the long-term advantage of the accounting treatment of post-retirement benefits. 66 Pa. C.S. § 2803; DII Statement No. 3-5, p. 21. Alternatively, if the Commission grants recovery for this regulatory asset, a corresponding regulatory liability must be created to return to ratepayers a rightful portion of the long-term benefit created by past over-payments of SFAS 106 costs. Id.

In addition, the Company's SFAS 106 regulatory asset claim is inappropriate under the Act because such costs are already being recovered elsewhere in the DLC stranded cost claim. Thus, the cost is not a "net" cost. 66 Pa. C.S. § 2803. Any excessive levels of ratepayer recovery necessitated under the accrual method of accounting are embedded in Duquesne's stranded generation cost claim. DII Statement No. 3, p. 21. Consequently, recovery of such costs as a separate regulatory asset amounts to an excessive double recovery for the Company.

Furthermore, SFAS 106 costs do not meet the definition under the Act of a stranded cost. Pursuant to the Act, a stranded cost must be a cost that was typically recoverable in the regulated environment but that will not be recoverable in the competitive environment. 66 Pa. C.S. § 2803 (emphasis added). All companies in the competitive generation environment will be subject to the provisions of SFAS 106. If all competitors are subject to these costs, the pricing in the competitive environment will necessarily ensure recovery of the costs; Duquesne's competitive position should not be enhanced by providing the Company for recovery of a cost that equally effects DLC and alternative suppliers.

The Company's claimed regulatory asset for SFAS 106 costs lacks a factual and statutory basis. The cost is not "stranded" because all suppliers in the competitive environment will be subject to SFAS 106. The cost is not a "net" cost because it does not account for earnings on the excess payments until the accounting treatment reverses. In addition, the cost is not "net" because it is also included in DLC's stranded generation cost claim. Because of these pervasive deficiencies, DII submits that the DLC claim for $4.22 million in SFAS 106 costs be rejected. In the alternative, if the regulatory asset were approved for recovery by the Commission, DII requests a corresponding regulatory liability, to compensate ratepayers for the return earned by the Company on the years of pre-payment of these costs, be recognized. DII recommends that the Commission deny recovery for this purported regulatory asset.

(k) Warwick Mine Costs

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(l) Pilot Program/Customer Education Expense

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(m) Compensated Absences

DII addresses this claim in Section IV. E. 2. e., supra.

(n) Injuries/Damages

DII addresses this claim in Section IV. E. 2. e., supra.

(o) Other

DII is addressing no other regulatory asset issues at this time but may respond, as appropriate.

3. Conclusion

DII adjustments to the Duquesne regulatory asset claims comply with the requirements of the Act. Duquesne's improper regulatory asset claims that are not stranded by the movement to competition (e.g., pre-accrual of nuclear outages, SFAS 106 deferred costs) must be rejected. The Company's claimed regulatory assets that are recovered in other portions of its filing (e.g., SFAS 109 Deferred

Taxes, Unamortized Debt Costs, Unamortized Sale/Leaseback Premium, Deferred Employee Costs) must also be rejected to prevent double recovery by the Company. Finally, all of Duquesne's other claimed regulatory assets were examined to ensure that they are properly recoverable under the Act and stated on a NPV basis. Based on these reasonable and appropriate adjustments, Duquesne should be permitted to recover $584.81 million (pre-tax) in stranded regulatory assets. A summary of the specific claims and DII adjustments is contained in Appendix A, Table 4, infra.

F. Recovery of Stranded Costs

1. Introduction

After the Commission has determined the properly claimed and quantified stranded costs that Duquesne has proved, by substantial evidence, will exist because of movement to competition, the PUC must determine what portion of these costs are properly recoverable from ratepayers through CTCs.[38] As explained in Section IV.E.1, supra, all properly claimed and properly quantified stranded regulatory assets are recoverable from ratepayers. With respect to stranded generation assets, however, the Act clearly mandates that only a just and reasonable level of properly claimable and quantified stranded costs are recoverable. See Section IV.A.1 & IV.B.1, supra.

DII proposes two methods to arrive at a just and reasonable level to recover from ratepayers First, the Commission should employ an equity return disallowance on stranded generating plant, similar to previous PUC treatment of generating costs determined not to be "used and useful." DII Statement No. 1, pp. 14-21. Second, the Commission must consider Duquesne's mitigation efforts, including the possibility of the Company issuing securitized debt. DII Statement No. 3, pp. 34-36.

2. *Proposals to Adjust the Level of Stranded Cost Recovery*

(a) Mitigation

Duquesne submits extensive testimony regarding its alleged historic and future mitigation efforts. See Duquesne Statement No. 2, pp. 3-21. DII takes no position on Duquesne's claimed past or

future mitigation efforts. DII Statement No. 1, p. 15. As explained in detail below, DII requests that the Commission strongly urge DLC to purse securitization of its stranded costs as a final mitigation strategy to arrive at a just and reasonable recovery from ratepayers. See Section IV. F. 2. C, infra.

(b) Sharing of Stranded Costs (OCA and DII)

The Act and prior Commission decisions mandate that a three-step process for determination of costs to be recovered from ratepayers be employed.[39]

As explained in Section IV.B.1, supra, one method to arrive at the recoverable level of stranded cost is via an adjustment to the stranded generation portion of the total claim. After Duquesne's total level of qualifying stranded generation costs is determined, the Commission may allow ratepayer recovery for only a "just and reasonable" portion of that total. 66 Pa. C.S. § 2808(c)(3).

DII recommends that an appropriate mechanism for Commission use to implement this mandating balancing of interests and determination of just and reasonable levels of recoverable generation-related stranded costs is the "equity return disallowance." DII Statement No. 1, p. 19.

> A fair and reasonable methodology would eliminate the equity component of return on the unamortized balance of stranded generation costs, during the seven year transition period in which the CTC is recovered.

Id. The equity return disallowance compares the revenue requirement NPV associated with stranded generation costs (at a fully grossed up return level with a common equity return component) to a similar calculation without a common equity component. Id.

The equity return disallowance has been previously used by the Commission regarding assets not used and useful. See e.g., Public Utility Commission v. Pennsylvania Power & Light Company, Docket No. R-842651, Order entered on April 26, 1985, 59 Pa. P.U.C. 332, aff'd, 101 Pa. Commw. 370 (1986) (disallowing return on common equity associated with Susquehanna Unit 2 because the unit was excess capacity). Stranded generation costs are, by analogy, no longer used and useful in the competitive market because stranded costs do not provide electric utility service in and of themselves.

DII Statement No. 1, pp. 15-16.[40] As in the past, the equity return disallowance represents a reasonable approach to making necessary adjustments to uneconomic generation costs to arrive at a just and reasonable customer recovery level. DII Statement No. 1, pp. 15-21. Based on the DII recommended level of stranded generation costs, the equity return disallowance should be $232.289 million (jurisdictional). Id. at 9, Exhibit SJB-2.

The Commission has previously stated that it considers the level of past and anticipated mitigation as an element in determining the just and reasonable level of recoverable stranded generation-related costs. PECO Restructuring Order, p. 100. However, the Commission also noted that it has the "discretion under Sections 2804(13) and (14) to disallow recovery of a portion of accurately quantified 2808(c)(3) stranded costs." Id. DII respectfully submits that exercise of that discretion is appropriate based on the evidentiary record in this proceeding. The use of the equity return disallowance is a reasonable method to arrive at a just and reasonable level of stranded costs to be recovered from ratepayers. DII respectfully requests that the equity return disallowance be employed in this proceeding.

(c) Securitization (DII Proposal)

Pursuant to Section 2812, the utility may request a qualified rate order ("QRO") for issuance of transition bonds to securitize any or all of its recoverable level of stranded costs. 66 Pa. C.S. § 2812. DII urges Duquesne to securitize its authorized level of stranded cost recovery in this proceeding as a final step of mitigation to reduce the amount of stranded costs that must be recovered from ratepayers. The Act specifically recognizes the issuance of securitized debt as a proper mitigation effort by the Company in determining the level of transition or stranded costs that an electric utility may recover through the CTC. 66 Pa. C.S. § 2808(c)(4)(vi).

Securitization of Duquesne's total stranded costs will reduce the amounts to be recovered from ratepayers, because the cost of capital used in the stranded cost determination will be replaced by the interest rate on the transition bonds, which will be less than the Company's requested cost of capital.

DII Statement No. 3, p. 34-35. This lower level of stranded cost recovery will result in the ratepayers paying a lower CTC, resulting in immediate rate reductions or a shorter CTC recovery period. Id. at 35.

The Commission previously endorsed securitization as necessary to benefit ratepayer interests during the transition period. The Commission specifically noted PECO's prior request for a qualified rate order under Section 2812 for part of its stranded cost claim as part of PECO's mitigation efforts pursuant to the Act. PECO Restructuring Order, slip op. at 98. The Commission also stated that its decision in the PECO proceeding was contingent on continuing efforts by PECO to mitigate stranded costs to be recovered from ratepayers. Such efforts should possibly include further securitization of its debt. Id. at 100-101. To the extent ratepayers may be benefitted by DLC pursuing securitization, the Commission should require the same of DLC as it has required of PECO.

DLC makes vague claims that securitization is not "economic" from the Company's perspective. See Duquesne Statement No. 2-R, pp. 52-54. However, the Company admits that no detailed studies exist to support that claim. Tr. at 242; Exhibit No. DJC-26. DII requests the PUC to encourage DLC to securitize all or a portion of its stranded costs to fully mitigate stranded cost levels under the Act.

It is clearly within the Commission's power, under its duty to ensure that the level of rates recovered from ratepayers are just and reasonable, to urge the utility to pursue securitization. In addition, the Commission can consider securitization as part of its evaluation of the DLC mitigation efforts. As stated in the PECO decision, evaluation of the utility's stranded cost claim and recovery is an ongoing process that is contingent on the utility's attempt to fully mitigate the effect that stranded costs will have on ratepayers. PECO Restructuring Order, slip op. at 101. PECO appears willing to securitize at least a portion of its stranded costs. Id. at 98. The Commission should demand no less of Duquesne with respect to securitization, than it has demanded of PECO on the same issue.

3. Methods of Stranded Cost Recovery

(a) Accelerated Amortization Under Section 2804(4)(v) (Duquesne's ROE Spillover Proposal)

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(b) Immediate Rate Reductions (OCA Proposal)

DII is not addressing this issue but may respond, as appropriate, in reply brief.

(c) Rate Cap/CTC Extension

Duquesne acknowledges that under its delayed valuation method for determining stranded costs, the Company may need an extension of CTC recovery period in order to fully recover stranded cost revenues that the Commission authorizes. Duquesne Statement No. 2, p. 41. Duquesne proposes to make this determination based on a CTC revenue analysis after the final delayed market valuation. Id. Duquesne seeks to extend or shorten the CTC collection period accordingly. Id. Although DII generally assents to the concept that the collection period be extended, its agreement is subject to certain conditions.

As a preliminary matter, DII notes that the Company's perceived need for an extension of the recovery period is created in large part by the Company's proposals to delay the market valuation of its assets and to have a variable CTC. DII's analysis, on the other hand, establishes a definitive level of stranded costs to be recovered and a fixed schedule of CTCs; DII submits, with a high degree of certainty, that if the DII recommendations are adopted (and Duquesne's sales remain comparable), Duquesne will fully recover its allowed stranded cost by 2002. DII Statement No. 1, p. 35, Exhibit SJB-5. This is the level of certainty with respect to stranded cost responsibility that should be given to the ratepayers and competitors in Duquesne's service territory. DII Statement No. 1, pp. 23-26.

DII does not necessarily object to the concept of extending the CTC collection period. However, the mere possibility of under-collection is not sufficient to warrant an automatic extension of the CTC recovery period. DII Statement No. 1, p. 32. If such under-collection is present at the end of the

statutory CTC recovery period, the Company should present evidence of the under-collection to the Commission and seek approval for an extension. Id. The DII position represents a reasonable compromise between the needs of DLC to the allowed level of stranded costs and for other market participants to ensure that the transition period is not unreasonably extended. See 66 Pa. C.S. § 2802(8).

In addition, *DII's assent* to the concept of CTC extension is contingent on a concurrent extension of the rate cap pursuant to Section 2804, 66 Pa. C.S. § 2804(4). DII Statement No. 1, p. 32. The rationale for including a rate cap in the Act was to protect the consumers who were held captive to the payment of a CTC. Id. The concerns that lead to adoption of the rate cap will be present if the CTC recovery period is extended and the consumers remain captive to the payment of a CTC. Not extending the rate cap would inappropriately benefit Duquesne without a correlating benefit to ratepayers in violation of Section 2802(8) of the Act, 66 Pa. C.S. § 2802(8).

An unconditional extension of the CTC recovery period should not be granted in this proceeding. If DLC experiences an under-collection of its allowed stranded costs, DLC should present evidence of that under-collection to the Commission. That request should not be granted until the Company makes a sufficient showing. In addition, any extension of the CTC recovery period must be accompanied by a concurrent extension of the generation rate cap. Extension of CTC recovery without a concomitant extension of rate cap is inequitable and violative of the Act. DII respectfully requests that DLC's premature request for rate cap extension be denied, *without* prejudice.

(d) Other Proposals

DII has no other proposals to address at this time. DII may respond to issues raised by other parties, as appropriate, in reply brief.

4. Other Arguments Regarding Recovery of Stranded Costs

DII has no other arguments regarding recovery of stranded costs to address at this time but may respond, as appropriate, in reply brief.

5. Conclusion

After the Commission determines DLC's properly claimed and correctly quantified level of total stranded costs, the Commission must take the further step to determine whether all of those costs are properly recoverable from ratepayers. First, the Commission must examine whether DLC has mitigated and will continue to mitigate stranded costs to the extent possible under the Act. DII submits that such future mitigation efforts should include securitization of all or a portion of the Company's stranded costs. Second, the Commission must determine a just and reasonable level of stranded costs to recover from ratepayers. DII recommends the Commission employ an "equity return disallowance" to DLC's stranded generation costs to strike the appropriate balance between the Company and its ratepayers and arrive at a just and reasonable level of recoverable stranded costs.

The Act requires that Duquesne have an opportunity to recover from ratepayers its stranded costs as calculated in this proceeding. 66 Pa. C.S. § 2808(a). In the event that Duquesne can submit evidence to the Commission near the end of the transition period that it will not recover its authorized stranded costs, the Commission could consider extending the CTC recovery period. Any decision to extend recovery should not be predetermined in this proceeding. In addition, any extension of recovery must be accompanied by a concurrent extension in the rate cap pursuant to Section 2804(4)(ii), 66 Pa. C.S. § 2804(4)(ii).

G. Conclusion

The calculation of DLC's proper level of stranded cost recovery is a critical issue in implementation of Chapter 28. Establishing a recovery level that is too high would certainly hinder development of the competitive market. Establishing a level that is too low may endanger the financial stability of the Company. Decisions of this issue must be based on the dictates of the Act and the need to balance these competing interests. The Commission has established the burden of proof to be used in the stranded cost determination under the Act.[41] PECO Restructuring Order, slip op. at 68.

Duquesne fails to meet this burden. As DII illustrates, many components of Duquesne's stranded regulatory asset claim are not properly quantified or not properly recoverable pursuant to the Act. The most blatant inadequacy occurs in Duquesne's stranded generation asset claim and arises from the Company's failure to quantify its generation asset market value. The Company's primary position is that this valuation can be delayed until 2003. As DII shows, a delay in asset valuation is clearly not authorized under the Act or Commission precedent. Consequently, Duquesne's proposals to value its assets in 2003 by an arbitration panel or a full or partial divestiture must be rejected. If divestiture is to be used to value Duquesne's generating assets, it must occur immediately and not be conditioned on a possible waiver by the Commission of ratepayers' statutory right to a rate cap during the transition period. Use of an arbitration panel to value any portion of Duquesne's generating assets at any time raises significant due process concerns because interested parties will not have a meaningful opportunity to participate in the process. Finally, any attempt by Duquesne to rely on its range of market prices should be rejected. The level of detail contained in that analysis is clearly not appropriate for use in this critical determination under the Act.

DII presents a comprehensive and reasonable analysis of DLC's properly recoverable stranded costs under the Act. All elements of the DII presentation fulfill the dictates of the Act and balance the interests of DLC, the DLC shareholders, competitors and ratepayers. DII proves that each component will recover the NPV of known and measurable, generation related stranded cost pursuant to the definition in the Act. A full recitation of the DII recommendation, in table form, is contained in Appendices A, B & C to this brief. The DII stranded cost analysis, as supported by the foregoing arguments, should be accepted by the Commission.

V. THE COMPETITIVE TRANSITION CHARGE

A. Conceptual Disputes Regarding Calculation of CTC/CGC

1. Differences in Overall Approach (e.g., CTC or CGC as Residual; OCA Proposal)

The Commission's determination of a CTC design methodology for the recovery of Duquesne's

stranded costs encompasses many sub-issues. The fundamental issue is the "overall approach" of the CTC design. In this brief, "overall approach" refers to whether the methodology uses a CTC residual approach or a competitive generation credit ("CGC") residual approach.

- Under the CTC residual methodology, transmission and distribution cost and the projected market price during each year of the transition period are subtracted from the total capped rate as of January 1, 1997, to determine the customers' CTC responsibility. DII Statement No. 1, pp. 33-35; Duquesne Statement No. 5, p. 63.

- Under the CGC residual methodology total stranded costs are allocated to rate classes for each year of the transition period. OCA Statement No. 4, pp. 14-15. That allocation of CTC and transmission and distribution costs are subtracted from the total generation component of the rates to produce the CGC. Id. The allocation can be based on a levelized recovery or some other type of recovery.

The choice of methodology is an overarching issue because use of one methodology or the other may dictate whether customers are economically able to participate in the competitive market during the transition period. DII Statement No. 1, p. 34. The development of the competitive market may be irreparably harmed by use of a CTC methodology that prohibits some classes of customers from accessing competitive supply.

DII submits that adoption of the CTC residual methodology by the Commission is clearly appropriate under the Act. First, the CTC residual methodology will provide for a more orderly transition to a competitive market. See 66 Pa. C.S. § 2804(14). Because the target market price and the anticipated market prices are related (and the calculation of the CTC is in effect subordinate to and dependent on projected market price) more customers will have the opportunity to economically participate in the competitive market. See DII Statement No. 1-S, p. 18.

> Under this approach, the market rate component of DLC's unbundled rate schedules would reflect expectations for market rates in each year of the transition period. As a result, if customers could obtain market rates at levels below the market generation rate component of DLC's unbundled rates in any given year, they would have an incentive to purchase power from an alternative supplier. This approach would result in an orderly development of a competitive market and provide opportunities for both customers and alternative generation suppliers to transact purchases and sales.
>
> Utilizing this approach to rate unbundling would give DLC's customers an opportunity to actually participate in the market.

DII Statement No. 1, p. 34.

Conversely, the CGC residual methodology may result in customers being economically prohibited from participating *in some* years of the transition period. As explained above, the CGC is determined by subtracting distribution, transmission and allocated CTC responsibility from capped rate. It is possible that the CTC allocation for any year plus the anticipated market price will exceed the generation rate cap. See DII Statement No. 1-R, p. 17.

> Although conceptually, Ms. Smith's approach of utilizing an expected market generation rate and an allocated CTC revenue requirement (using a production demand allocation factor) could be utilized, in the case of Duquesne Light Company, the OCA's proposal will violate the generation rate cap provisions of the Competition Act for a number or rate schedules including rate HVPS.
>
> Based on my preliminary review, one of the reasons for the violation of the rate cap under the OCA proposal for Rate Schedule HVPS is that the production revenue requirement proposed to be utilized in the analysis does not reflect: 1) the presence of interruptible sales on Rate Schedule HVPS, 2) the nature of limited availability "avoidance generation energy" among Rate Schedule HVPS customers and other supplemental energy purchases, all of which are reflected at full cost responsibility in the production demand revenue requirement but are not reflected at full rate levels in the bundled rates that are used in the unbundling process. As a result, these customers, when assigned fully loaded transmission and distribution charges, expected market generation cost and fully allocated CTC revenues, are assigned costs under the OCA proposal in excess of actual current rates. As proposed, this is not a feasible for rate unbundling on the Duquesne system and would lead to a violation of the generation rate cap for a number of rate classes.

Id. If the allocated CTC plus the actual market price exceeds the rate cap, customers will naturally return to bundled Duquesne service in that year, and forego participation in the competitive market place.

Furthermore, under the CTC residual methodology proposed by DII, because the projected market price increases each year, the correlating CTC decreases. DII Statement No. 1, pp. 46-47, Exhibit Nos. SJB-7, SJB-8 & SJB-9. This decreasing CTC, over the years, will transition customers to the time when the CTC is no longer being recovered and supply decisions can be made without considering stranded cost liability. This is an appropriate process to segue customers to the fully

competitive market where decisions are based only on the price of electricity.

The CGC residual methodology is inappropriate for use in this proceeding. As applied by the OCA, the methodology results in violations of the rate cap for certain customer classes. Certainly, a CTC methodology that on its face will conflict with other components of the Act cannot be endorsed by the Commission. The DII analysis based on the CTC residual methodology will advance the development of a competitive market and result in an orderly transition to full competition. For these reasons, DII respectfully requests that the Commission use the CTC residual methodology in determining the CTC for the various Duquesne rate classes.

2. Other Conceptual Disputes

(a) CGC Calculation: Annual Adjustments v. Fixed Schedule

Another conceptual difference among the CTC proposals in this proceeding is whether the schedule of CTC and CGC charges for each year of the transition period should be established definitively as part of this proceeding or whether the CGC and CTC should vary each year. DII and OCA propose to firmly establish the CTC responsibility for each customer class as part of this proceeding. DII Statement No. 1, p. 33; OCA Statement No. 4, pp. 14-15. Duquesne, on the other hand, would like to delay the CTC and CGC determination until the year before the particular CTC is to be collected from ratepayers. Duquesne Statement No. 5, pp. 56-62. Duquesne would determine the yearly CGC (and correlating CTC) based on its annual sale of a block of firm power ("the reverse RFP"). Id. at 56.

The establishment of a fixed schedule of CTC as part of this proceeding is clearly necessary under the Act. Duquesne's proposal for annual adjustments will hinder development of competitive markets. In addition, annual adjustments to the CTC are inconsistent with Commission precedent. See PECO Restructuring Order, slip op. at 103-113.

The Duquesne proposal to adjust the CTC annually based on the results of a yearly reverse RFP

will hinder the development of the competitive market. DII Statement No. 1, pp. 23-25. In order for customers, and specifically large customers, to effectively participate in the market, customers must have sufficiently stable information to make decisions. DII Statement No. 1-S, p. 13. Many large customers will want to enter into contracts for a duration of more than one year in order to lock in levelized, long term rates. Customers will not be able to evaluate these contracts if the CTC responsibility for the following year is not determined until Duquesne conducts the RFP. Id. at 12. This will sharply inhibit the willingness and ability of customers to enter into this longer term supply option that clearly would occur in a competitive market place.

In addition, the fixed CTC methodology was adopted by the Commission in the PECO restructuring proceeding. PECO Restructuring Order, slip op. at 109-113. As aforementioned, use of the variable CTC injects substantial uncertainty into the supply decisions made by customers. Duquesne's ratepayers deserve at least the same level of certainty afforded to PECO's ratepayers in this regard. DII Statement No. 1, p. 25. The spirit of balancing stated in Chapter 28 mandates that the fixed CTC methodology also be used for design of Duquesne's CTC. 66 Pa. C.S. § 2802(8).

Furthermore, use of a fixed CTC strikes the appropriate balance between Duquesne, its shareholders, ratepayers and competitors. 66 Pa. C.S. § 2802(8). Under the Duquesne proposal, the variable CTC ensures that Duquesne (and its shareholders) will continue to collect at least the revenues it currently collects for generation. DII Statement No. 1, p. 24. The risk of the transition to the competitive market is placed entirely on customers and competitors. First, customers bear the risk that their pricing decision will not be the best deal that could have been made. Second, customers and competitors bear the risk that the price agreed to for electricity transactions will deviate from the results of Duquesne's reverse RFP. Customers and competitors bear the total risk of market price fluctuation, while Duquesne and its shareholders are essentially held harmless. This is not the balancing of interests contemplated by the Act. 66 Pa. C.S. § 2802(8).

The DII approach of establishing fixed yearly CTCs is clearly superior. The Duquesne proposal to have a variable yearly CTC is inappropriate, detrimental to the development of the competitive market, and contrary to the intention of the Act. The proposal must be rejected. DII submits that the Commission should establish a fixed schedule of CTCs for each year of the transition period as part of this proceeding using the methodology DII recommends.

(b) Determination of Class Responsibility for Stranded Costs

Another dispute regarding establishment of the CTC for recovery of Duquesne's properly claimed, quantified, and recoverable stranded costs is whether the CTC methodology should specifically assign an allocation of the total stranded cost to each rate class. Duquesne and DII do not perform specific allocations of stranded cost to rate classes. Duquesne Statement No. 5, pp. 56-62; DII Statement No. 1, pp. 33-34. The CTC residual methodology used by DII and Duquesne results in an appropriate determination of each class's stranded cost liability based on the "stranded" costs currently in bundled rates.

OCA and OSBA propose a specific assignment of stranded costs to each class based on a production demand allocation factor. See OCA Statement No. 4, p. 9; OSBA Statement No. 2-R, pp. 2-4. Use of this methodology is inappropriate because it results in cost-shifting and possible rate cap violations, both of which are prohibited by the Act. 66 Pa. C.S. §§ 2804(4) & 2808(a). In addition, the residual CTC methodology utilized by DII (and the Company) results in an appropriate assignment of these costs without the need for complex allocations. The DII residual CTC methodology should be accepted by the Commission.

Although the allocated methodology was accepted in the PECO proceeding, use of that methodology would be inappropriate for this proceeding because it would result in needless violations of the rate cap and anti-cost shifting provisions of the Act. 66 Pa. C.S. §§ 2804(4) & 2808(a). Proposals submitted by the OCA and the OSBA violate the generation rate cap provision of the Act for a number

of rate schedules including rate HVPS. DII Statement No. 1-R, p. 17; DII Statement No. 1-S, pp. 18-19. Although OCA acknowledges the potential for rate cap violation, it offers no definitive solution; OCA simply states that the rate cap will take precedence. OCA Statement No. 4-S, p. 7. DII submits that this represents a fundamental flaw in the allocated CTC methodology. It is inequitable to endorse such disparate treatment of customer class. 66 Pa. C.S. § 2804(7). This situation is clearly antithetical to the development of the competitive market envisioned by the Act.

In addition, use of the allocated CTC methodology will result in the need for complex allocations regarding services such as Interruptible Service, Generation Avoidance Energy and special contracts. If these customers, who currently take service under rate HVPS are assigned fully loaded transmission and distribution charges, expected market generation costs, and fully allocated CTC revenues, the total rate will exceed the customers' current rates. DII Statement No. 1-R, p. 17; DII Statement No. 1-S, pp. 18-19. If the allocation methodology is not adjusted to account for Interruptible Service, Generation Avoidance Energy and special contracts, the resulting CTC violates the rate cap and shifts recovery of stranded costs away from other ratepayers. Id.

Stranded costs must be unbundled as they are contained in current rates. Pursuant to this allocation methodology the Act prohibits interclass or intraclass cost shifting.[42] 66 Pa. C.S. § 2808(a) (emphasis added). OCA blindly adheres to its allocation methodology by stating "the Act does not specifically allow for any corrections to previously utilized allocators." OCA Statement No. 4, p. 7. However, the Commission in developing the CTC for the recovery of Duquesne's stranded costs must adhere to both of the requirements. 66 Pa. C.S. § 2808(a). To blindly adhere to an obviously flawed allocation methodology despite concrete evidence of unauthorized cost shifting is clearly unwarranted under the Act. Id.

Moreover, the residual CTC methodology proposed by DII is entirely consistent with the Act's directive on cost shifting and allocation issues. 66 Pa. C.S. § 2808(a). The residual CTC methodology

calculates stranded cost responsibility based on the difference between the generation-related cost within each class's current rates (the total generation component of the rate) and the anticipated market price for that rate. DII Statement No. 1-S, p. 18. The difference between embedded costs in current rates as determined and allocated in the last base rate proceeding, and the current anticipated market price for each rate schedule is the true stranded cost created by customers in that rate schedule by the opportunity to access the competitive market. Id. Thus, the residual CTC methodology adheres to the rate cap provision of the Act, the anti-cost shifting provision of the Act, and the concept that stranded costs should be allocated in the manner implicit in the rates established in the last base rate proceeding. 66 Pa. C.S. § 2808(a).

It is unnecessary to specifically allocate portions of DLC's total stranded costs to rate schedules for recovery. The residual CTC methodology used by DII permits CTC establishment that complies with the Act without need for complex adjustments to an allocation factor. In addition, if the OCA/OSBA recommendations are accepted, the generation rate cap is exceeded unless the allocation factors are adjusted. OCA and OSBA do not provide an adequate adjustment to address DII's concerns. DII submits that use of the CTC residual methodology is clearly the superior approach that should be accepted to determine each rate class's stranded cost responsibility.

(c) Levelized CTC v. Other Methods

Another issue related to the CTC methodology is whether a levelized CTC will be used. The use of a levelized CTC provides for the recovery of approximately the same portion of the Company's stranded cost during each year of the transition period. The opposite of the levelized recovery would be a CTC that varies each year based on factors such as expected market price or, theoretically, based on no rational factor at all. See e.g., OCA Statement No. 4, pp. 14-15.

Use of a levelized CTC for the recovery of Duquesne's stranded costs may be inappropriate, because, depending on the total stranded costs authorized in this proceeding, levelizing recovery of those

costs over the transition period may prevent some customers from participating in the competitive market. Unlike the residual CTC methodology, under a levelized recovery, no inherent relationship exists between the expected market price in a year and the CTC to be recovered from the customer during that year. DII Statement No. 1, pp. 32-34. Because of the rate cap, unless a relationship is manufactured between the levelized CTC and the market price, the total of the allocated CTC revenues in any given year plus, the anticipated market price could exceed the rate cap. In such situation, customers would logically return to the utility's bundled service and abandon the competitive market. Ironically, because market prices are expected to rise throughout the transition period, this "customer flight" back to bundled service could occur in the latter years of the transition period when the goal should be to encourage the further development of a robust competitive market.

The use of a levelized CTC that does not have an inherent correlation with the expected market prices will thrawt the pro-competitive goals of the Act. Neither the OCA nor the OSBA proposal contains any relationship to the anticipated market price of electricity; as a result, DII shows each will violate the rate cap for HVPS customers. DII Statement No. 1-R, p. 17 & DII statement No. 1-S, pp. 18-19. Because neither party has adequately addressed this obvious flaw in the allocated levelized CTC methodology, DII respectfully requests that the Commission reject the levelized CTC.

(d) Duquesne's Rate Redesign Proposal

Duquesne proposes a mandatory rate redesign that collects 50% of the customer's monthly CTC charge on a fixed dollar per month basis and 50% on a consumption basis. See Duquesne Statement No. 5, pp. 63-69. DII submits that the Commission must reject this proposal because, as set forth in more detail below, it violates the rate cap and anti-cost shifting provisions of Chapter 28 (66 Pa. C.S. §§ 2804(4) & 2808(a)) and because Duquesne has presented no valid justification for the extraordinary proposal. In addition, the proposal is contrary to the purpose and intent of Chapter 28 because it harms all customers whose load may be decreasing due to negative business concerns.

The Duquesne proposal violates the rate cap and anti-cost shifting prohibitions contained in Chapter 28. 66 Pa. C.S. §§ 2808(a) & 2808(4). The rate redesign amounts to a "take-or-pay" charge for 50% of stranded cost recoverable by Duquesne. DII Statement No. 1, pp. 49-53. No such take-or-pay liability is currently in Duquesne's bundled rates for large service customers Consequently, on a risk adjusted basis, Duquesne customers forced to use the rate redesign will pay higher rates than they will otherwise pay under currently applicable bundled service rates. Id. at 52. The "redesign" changes cost allocations based on embedded costs in Duquesne's bundled rates that are specifically mandated to remain constant under Chapter 28. 66 Pa. C.S. § 2808(a). A proposal with such blatant defects cannot be accepted by the Commission.

In addition, the Duquesne proposal is contrary to the economic development goal of Chapter 28 regarding retention of businesses in the Commonwealth. One of the policy findings of Chapter 28 is that "the cost of electricity is an important factor in decisions made by businesses concerning locating, expanding **and retaining facilities in this Commonwealth.**" 66 Pa. C.S. § 2802(6) (emphasis added). As OSBA explains:

> Duquesne proposes to make its rate redesign mandatory for all customers. Accordingly, the Company's proposed Fixed CTC charge will result in larger bills for all customers with baseline consumption levels that are for any reason higher than normal (compared to the all-variable CTC case). Relative to existing rates, this equivalent to a shift in CTC revenue responsibility from customers with growing loads to customers with declining loads.

OSBA Statement No. 1, pp. 13-14. The DLC proposal is clearly inconsistent with the business retention purposes of the Act because the Duquesne proposal will place higher costs on a struggling business at the precise time that the business must be cutting costs to survive. The DLC proposal will either cause the business to fail or to move to a more cost-effective environment. A proposal that obviously impedes the economic development purposes of the Act must be rejected.

Furthermore, the Duquesne rate design is an exclusively self-interested proposal. Through the customized rate design, Duquesne is able to inappropriately shift to customers the risk of the variability

of usage. DII Statement No. 1, p. 51. The imposition of this take-or-pay charge substantially reduces the risk of recovery associated with 50% of the otherwise applicable stranded cost recovery through the CTC charge. Id. This proposal benefits only Duquesne and must be rejected.

This shifting occurs without valid justification from the Company. The Company *failed to* produce any evidence to support its claim that economic efficiency will be enhanced by the proposal. Id. Because the proposed rate has not become effective, Duquesne has the burden of establishing its reasonableness. 66 Pa. C.S. §§ 315(a) & 332(a). The only evidence produced by Duquesne is the unsupported assertion of efficiency gains. DII has clearly demonstrated that the proposal has serious anti-competitive effects and otherwise violates Chapter 28.

The proposed rate redesign inappropriately shifts the risk of recovery for a substantial portion of DLC's stranded costs away from the Company and on to ratepayers. This shift violates the rate cap and anti-cost shifting provisions of the Act. DII submits that the proposal is unreasonable and without valid justification. The proposed rate redesign should be rejected.

In its rebuttal testimony, the Company states that it will offer its rate redesign on an optional rather than mandatory basis. Duquesne Statement No. 5-R, p. 45. In the event that the Commission rejects DII's arguments to completely eliminate the rate redesign, the Duquesne alternative proposal would be acceptable. DII Statement No. 1-S, p. 14.

(e) Other Conceptual Disputes

DII has no other conceptual disputes to address at this time; DII may respond, as appropriate, in reply brief.

B. Other Disputes Regarding Specific Proposals

1. Duquesne Light Company

Duquesne proposes to use the CTC residual methodology where the CTC/CGC will be determined on an annual basis according to the results of Duquesne's reverse-RFP for a portion of its

load. Although DII supports the use of the CTC residual methodology, Duquesne's proposal to use the annual RFP results is inappropriate. As explained in Section V.A.2.a, supra, the CTC for each year of the transition period must be firmly established as part of this proceeding and cannot vary annually. Use of a CTC that varies annually will inhibit the ability of customers to participate in the competitive market. This is clearly contrary to the goals of the Act.

Duquesne states that it would be willing to establish a fixed schedule of CTCs for customers willing to give up their right to return to bundled service at the rate cap. Tr. at 541-542. The Company's "compromise" in this regard ignores the balancing of interests reflected in the Act. As long as Duquesne is permitted to recover "stranded" costs, Duquesne must offer customers bundled sales service at the rate cap levels. 66 Pa. C.S. § 2804(4). Existence of captive ratepayers to recover stranded costs during the transition period necessitate the need to protect those captive customers during the stranded cost collection period. For Duquesne to offer to provide customers with the CTC certainty that is clearly appropriate under the Act only if the customers are willing to give up their statutory right to a rate cap under the Act, evinces an intent to exploit the transition to a competitive market to the Company's advantage and to the ratepayers' detriment.

The Act entitles ratepayers to the protection of a rate cap. As explained in the previous sections, DII believes customers are also entitled to a fixed schedule of CTCs. To suggest that customers must give up this right in order to have a guaranteed CTC level eviscerates the intended balancing of interests reflected in the Act. 66 Pa. C.S. § 2802(8). DLC's attempts to force a "compromise" between ratepayers and the Company in this regard are inappropriate and must be rejected.

2. OCA

The OCA recommends a CTC design based on an allocated, levelized methodology.[43] OCA Statement No. 4, pp. 9 & 14. As previously discussed, use of this methodology is clearly inappropriate and has been shown by DII to result in inappropriate cost shifting. In addition, the OCA CTC

calculations for customers other than the residential class lead to potential violations of the statutory rate caps because of this cost shifting. DII Statement No. 1-R, p. 17. For these reasons, the OCA proposal is clearly inappropriate and cannot be accepted by the Commission.

3. *DII*

DII proposes to use the CTC residual methodology to produce a fixed schedule of CTCs to be recovered from each customer class for each year of the transition period. DII Statement No. 1, pp. 33-35. The yearly CTC is calculated by subtracting the projected market price for that year from the unbundled generation component of each class's rates. This market price is the same market price used in DII's calculation of the Company's stranded generation cost. The DII method appropriately recognizes that stranded costs and the CTC are a part of current bundled rates; stranded costs are not simply a number derived disjunctively from the unbundling process and grafted onto each rate schedule (as stranded costs are treated under other proposals). The DII CTC methodology allows customers concrete information upon which to make choices in the competitive market. In addition, because of the relationship between projected market price and the CTC, the DII approach offers better opportunity for customers to economically participate in the competitive market during the transition period. On the whole, the DII methodology is the most appropriate CTC methodology to obtain the goals of the Act. DII respectfully requests that the Commission adopt the DII CTC methodology.

4. Other Proposals

The OSBA endorses a CTC methodology similar to the OCA's allocated, levelized approach. See OSBA Statement No. 1-R, pp. 2-9. As previously explained, both the OCA and OSBA CTC proposals result in inappropriate cost shifting and violate the rate cap. These results make the OSBA proposal inappropriate for Commission adoption.

C. Other Issues Addressed in PECO Order

In order to ensure that the Company does not over-recover stranded costs, a CTC revenue

tracking mechanism must be established. DII suggests that the Company should track CTC revenues on a monthly basis. The Company will begin the stranded cost recovery period with the unamortized total stranded cost balance authorized in this proceeding to be recovered from ratepayers. This balance will accrue interest monthly at the revenue requirement level (i.e. fully grossed-up cost of capital). Each month, the Company will accumulate the CTC revenues produced that month by each rate schedule. The unamortized stranded cost balance will be reduced each month by the accumulated monthly CTC revenues until the balance is fully amortized at a $0 level. At that point, CTC collection will be terminated. The DII proposal represents a reasonable and timely method to track CTC collection and should be adopted by the Commission. DII Statement No. 1, pp. 30-31.

D. Conclusion

The DII CTC calculation methodology based on a CTC residual approach with fixed yearly CTC determined based on anticipated market price is clearly appropriate and balances interest of all participants during the transition period.

The DII proposal encourages development of the competitive market by providing all customer classes with a realistic opportunity to benefit from obtaining competitive supply. The DII CTC methodology should be accepted by the Commission. The DLC CTC methodology is clearly inappropriate. The DLC methodology does not provide customers with the level of certainty necessary to make rational and well informed decisions during the transition period. DII submits that the DLC proposal does not adequately further the goals of the Act; consequently, the DLC methodology must be rejected.

The OCA/OSBA methodology to determine CTCs based on a levelized, allocated recovery is not appropriate. As DII illustrates, the OCA and OSBA proposals contain inherent and fundamental flaws that violate the anti-cost shifting and rate cap provisions of the Act. 66 Pa. C.S. §§ 2808(a) & 2804(4). Because of this inconsistency with the requirements of the Act, DII submits that the OCA and

OSBA proposals must be rejected.

VI. RATE OF RETURN/DISCOUNT RATE

DII is not addressing this issue but may respond, as appropriate, in the reply brief.

VII. SPECIAL CUSTOMER CLASSES

A. Rule 4 Contracts

Duquesne inappropriately denies customers currently taking service under Rule 4 contracts the right of choice of electricity supplier guaranteed to them by the Act because Duquesne refuses to unbundle these contracts. Duquesne Statement No. 6-R, p. 4. This refusal is anti-competitive, contrary to the Act and must be rejected by the Commission. Rule 4 customers must be granted their statutory right to direct access unless the particular contract clearly prohibits the customer from accessing competitive supply in the deregulated environment for the duration of the transition period. DII Statement No. 1, p. 54.

Rule 4 contracts have given the Company discretionary pricing ability with customers in order to address "changing business needs or operating conditions." Duquesne Statement No. 5, Exhibit JAL-12, p. 7. Instead of losing this load, Duquesne has flexibility under its tariff to enter into special contracts at price levels less than tariff rates. Duquesne Statement No. 6-R, p. 4. Customers are required to sign a 5 to 10 year contract in order to take advantage of this service. Duquesne Statement No. 5, Exhibit JAL-12, p. 7. Consequently, some customers are bound by this contractual obligation despite the movement to a deregulated market beginning on January 1, 1999.

Rule 4 contract customers must be permitted to access alternative suppliers unless the specific contract between the customer and Duquesne prohibits such access. DII Statement No. 1, p. 54. As recognized in the PECO restructuring decision, "there is no statutory suggestion that any class of customers can be denied the opportunity to shop." PECO Restructuring Order, slip op. at 118. The Commission required PECO to unbundle existing contracts for customers as long as that contract does

not prohibit accessing alternative supply. Id. at 120. The Commission must require that Duquesne also unbundle its special contracts. DII offers as suitable method for unbundling Rule 4 contracts. See DII Statement No. 1, p. 54. The CTC derived from this analysis will be applicable to the customer if it continues taking service from Duquesne or if it begins taking service from an alternative supplier. Id.

The DII unbundling methodology of Rule 4 contracts is consistent with the Commission's Order in the PECO restructuring proceeding and should be accepted by the Commission for the unbundling of Duquesne's Rule 4 contracts. See PECO Restructuring Order, slip op. at 116-121. The Act and the Commission are clear that no class of customers can unreasonably be denied access to the competitive market. DLC's refusal to unbundle Rule 4 contracts is a blatant and unwarranted attempt to deny these customers access to the competitive market that must be rejected. DII respectfully requests the Commission require DLC to unbundle Rule 4 contracts on the basis set forth above.

B. Riders 8 and 20

Duquesne proposes to eliminate the economic development incentive rates currently available to existing customers in Tariff Rider 8 "Industrial Economic Development Rider for Customers at Existing Service Locations" and Tariff Rider 20 "Small Business Development Rider." Duquesne Light Company Supplement to No. 4 to Tariff Electric Pa. P.U.C. No. 17, issued May 28, 1997, pp. 71-76 & 100-103 (hereinafter "DLC Tariff"). These rates are proposed to be phased-out as customer contracts expire over the next five years. Duquesne Statement No. 6, p. 18. This phase out is clearly inappropriate under the Act and must be rejected.

Chapter 28 guarantees that the generation component of rates is capped at the January 1, 1997, level for the entirety of the transition period. 66 Pa. C.S. § 2804(4)(ii). Eliminating the credits before the end of transition period will increase the rates of current Rider 8 and 20 customers above the January 1, 1997 level. Under Rider 8, existing customers receive a percentage discount to incremental capacity and energy charges when the customer's usage for a month ("current Billing Demand") exceeds

a baseline monthly usage established by DLC for the customer ("Monthly Base Period Billing Demand") by a specified percentage ("5%"). DLC Tariff, pp. 71-72. The more a customer's usage exceeds the baseline, the higher the percentage discount provided to the customer. Id.

Rider 20 provides the following economic incentive credit to Rate GS/GM customers:

> A qualifying customer will earn a separately stated credit equal to the Billing Demand minus the Monthly Base Period Billing Demand multiplied by the discounted Incremental Unit Capacity Charge of Rate GS/GM. The minimum Monthly Base Period Billing Demands for new or existing customers will be five (5) kW. The percentage discount is 50% for the first 36 months, 30% for the next 12 months and 15% for the last 12 months the customer is on this rider.

DLC Tariff, p. 100.

These discount schedules were part of customers' rates as of the effective date of the Act. Eliminating the discounts raises the rates of Rider 8 and 20 customers above January 1, 1997, levels in the amount of the previously available discounts, in violation of the Act's rate cap. 66 Pa. C.S. § 2804(4). The Commission must not endorse such an obvious violation of the Act.

In addition, the Commission stated in the PECO decision that,

> All existing tariffs shall remain available through the transition period, and all special contracts shall remain in force, except as modified pursuant to this Opinion and Order or other tariff modifications approved by the Commission.

PECO Restructuring Order, slip op. at 117. The Commission mandated that PECO continue to offer rates such as the PECO's Economic Efficiency Rider ("EER") to existing customers until the end of the transition period. Id. at 118. The Commission should afford equivalent protection to the existing customers on economic development rates in the Duquesne service territory. The Company's proposed elimination of the Rider 8 and 20 credits prior to the end of the transition period must be rejected.

Moreover, the Company proposes to continue to offer economic incentive rates to new customers at new service locations. Duquesne Statement No. 5, Exhibit JAL-12, pp. 104-107. This discriminatory treatment is unwarranted. The Act clearly recognizes that the attraction and retention of businesses is necessary to promote the economic welfare of the Commonwealth. 66 Pa. C.S. §§

2802(6) & (7). Elimination of the credits prior to completion of the transition period may increase current customers' energy cost, which, as recognized by the Act, "is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth." 66 Pa. C.S. § 2802(6). Apparently, Duquesne is only willing to support the business attraction goals of the Act and intends to completely ignore the business retention goals. 66 Pa. C.S. §§ 2802(6) & (7).

In addition, the Act requires that "restructuring of the electric utility industry be implemented in a manner that does not unreasonably discriminate against one customer class to the benefit of another." 66 Pa. C.S. § 2804(7). DLC's elimination of the Rider 8 and 20 credits for existing customers blatantly discriminates against existing customers. DII Statement No. 1, p. 59. This discrimination is unreasonable because there is no rational basis to distinguish between the business attraction goals of the Act and the business retention goals. 66 Pa. C.S. § 2802(6). Both attraction, retention and expansion are necessary for economic prosperity.[44] Finally, the discriminatory treatment may create competitive disadvantage situations between existing and new customers. DII Statement No. 1, p. 59. This is clearly contrary to intentions of the Act and is not the equitable balancing of interests required during the transition period. 66 Pa. C.S. § 2802(8).

DLC's proposal to eliminate Riders 8 and 20 for existing customers is clearly contrary to the Act and must be rejected. Elimination of the Riders circumvents the generation rate cap that is available to all customers as a consumer protection, while DLC collects stranded costs. In addition, elimination of the credits for existing customers, while continuing the availability for new customers is discriminatory, unreasonable and contrary to the Act's economic development goals. DII respectfully requests the Commission mandate Riders 8 and 20 remain available to existing customers throughout the transition period.

C. Self-Generation

DII is not addressing this issue but may respond, as appropriate, in reply brief.

D. Other Tariff-Related Issues

Three other tariff-related issues must be addressed in this proceeding. DLC proposes changes to its current tariff for Interruptible Service (Rider 7), Time-of-Day Service (Rider 5) and High Voltage Power Service (HVPS) that are inappropriate and must be rejected. As explained below, all DLC tariff offerings must remain intact throughout the transition period in order to provide customers with the rate cap protection mandated by the Act. See 66 Pa. C.S. § 2804(4). Only tariff changes necessary to unbundle rates and introduce competition for generation supply are appropriate during the transition period while customers are captive to the payment of a CTC.

1. Interruptible Service (Rider 7)

Duquesne submits a tariff for Interruptible Service that makes two significant changes to the rate. See Duquesne Statement No. 5, Exhibit JAL-12, pp. 95-97; compare DLC Tariff, pp. 68-70. Both changes are unreasonable and not necessary to introduce the competitive generation supply option to DLC's service territory.

Duquesne's proposed tariff rider for Interruptible Service contains the following provision:

> Customers must contract under this rider prior to December 31, 1998 and must take full service from the Company as defined in the applicable rate schedules to qualify.

Duquesne Statement No. 5, Exhibit JAL-12, p. 95. This provision places two restrictions on the availability of Interruptible Service, neither of which is in the current tariff. See DLC Tariff, pp. 68-70. These restrictions are inappropriate and must be rejected.

First, the Act authorizes submission of tariff changes only to the extent necessary to modify the current tariff to accommodate:

> ... unbundled prices or rates for generation, jurisdictional transmission, distribution and other services; a proposed competitive transition charge; a proposed universal service and energy conservation cost-recovery mechanism; procedures for ensuring direct access to all licensed electric generation suppliers...

66 Pa. C.S. § 2806(e). The proposed availability restrictions are not connected to any of these purposes.

DII Statement No. 1, p. 56. Consequently, the charges can't be categorized as authorized or necessitated by the Act.

Furthermore, customers must have the option to remain on Interruptible Service for a portion of their load. Under the DII proposal for the phase-in of retail access, all customers may participate in the first and second stages of the phase-in for a portion of their load. If the DII pro-rata phase-in is adopted, interruptible customers wanting to participate in the market during the phase-in will be forced to revert to Duquesne's firm service for the remaining portion of the load because they will no longer qualify as "full service customers." DII Statement No. 1, p. 55-56. This reversion will result in a rate increase for these customers (in violation of the Act's rate caps) and will deter their ability to participate in direct access during phase-in. The Duquesne proposal will not foster the competitive market sought by the Act.

In addition, the Company offers no justification for the proposed restrictions. The Company's rebuttal testimony regarding tariff issues fails to mention DII's objections. See Duquesne Statement No. 5-R, Exhibit JAL-14, p. 19 (addressing HVPS tariff-related issue) & Duquesne Statement No. 6-R, pp. 2-7 (addressing economic development riders and Rule 4 contracts). Because the proposed changes in the Interruptible Service rider have not become effective, Duquesne has the burden of establishing the reasonableness of its proposal. 66 Pa. C.S. §§ 315(a) & 332(a). DLC fails to satisfy this burden. The proposed restrictions on the availability of Interruptible Service are unsupported by the Company and unnecessary to introduce the competitive market for generation supply.

The Duquesne restrictions on the availability of Interruptible Service are unreasonable and not authorized under the Act. The only tariff changes permissible in the context of this restructuring proceeding are those necessary to introduce a competitive market for generation supply in Duquesne's service territory. DII submits that limiting Interruptible Service to customers taking full requirements service as of December 31, 1998, is not necessary or appropriate under the Act to introduce competition

in the Duquesne service territory. Moreover, Duquesne fails to support the reasonableness of the proposed restrictions. DII requests the Commission reject the proposed availability restrictions on Interruptible Service.

2. Time-of-Day Rates

Duquesne proposes to restrict the availability of Time-of-Day service (Rider 5) to customers that contract prior to December 31, 1998. Duquesne Statement No. 5, Exhibit JAL-12, p. 92. This restriction is not present in the current tariff. See DLC Tariff, pp. 65-66.

The arguments stated in the previous section regarding Interruptible Service apply with equal force to the proposed change in the availability of Time-of-Day service. See DII Statement No. 1, p. 56-57. DLC fails to establish the reasonableness of its proposed tariff change. See 66 Pa. C.S. §§ 315(a) & 332(a). DII submits that the change is unreasonable and must be rejected.

3. HVPS

The Company's proposed tariff omits the provision in the HVPS tariff with regard to "Generation Avoidance" energy. Duquesne Statement No. 5, Exhibit JAL-12, p. 60-66. Generation avoidance is designed to permit an HVPS customer that produces a portion of its energy requirement for its own use with internal generating equipment to purchase electricity from Duquesne and avoid the use of alternative energy sources when its equipment fails. DII Statement No. 1, p. 57. The Company acknowledges that generation avoidance was inadvertently omitted and agrees to reinsert the provision in the final tariff to be submitted as part of the compliance filing in this proceeding. Duquesne Statement No. 5-R, Exhibit JAL-14, p. 19. This reinsertion of the provision alleviates DII's concerns with respect to Generation Avoidance in this part of the proceeding. DII Statement No. 1-S, p. 14. DII recommends that the Commission require the Generation Avoidance section to be reinserted in the compliance filing by Duquesne in this proceeding.

VIII. COMPETITIVE SAFEGUARDS

DII is not addressing issues regarding "Competitive Safeguards" at this time; however, DII may respond, as appropriate, in reply brief.

IX. DUTY TO SERVE

DII is not addressing issues regarding "Duty to Serve" at this time; however, DII may respond, as appropriate in reply brief.

X. UNIVERSAL SERVICE AND ENERGY CONSERVATION

A. Introduction

The Act requires that the Commonwealth maintain the existing level of universal service protection afforded to the low income citizens in Pennsylvania. 66 Pa. C.S. § 2802(10). The Duquesne funding mechanism appears to adhere to the dictates of the Act and should be accepted by the Commission. DII Statement No. 1-R, pp. 3-5.

B. Overall Funding and Rate Issues

1. Eligibility and Funding Levels

DII is not addressing this issue but may respond, as appropriate, in its reply brief.

2. Cost Allocation and Rate Design

The Act requires that existing protection policies and services assisting low-income customers must, at a minimum, be maintained. 66 Pa. C.S. § 2802(10). The Commission instituted a generic proceeding to address universal service issues because "the subject matter of these guidelines requires consistent policy determinations to be applied across the local distribution service territories." Guidelines for Universal Service and Energy Conservation Programs Made Pursuant to 66 Pa. C.S. §2803, §2802(17), 2804(8) and 2804(9), Docket No. M-960890F00010, Order entered on July 11, 1997 ("Universal Service Order").

DLC proposes to allocate universal service costs to classes based on the allocation currently

embedded in each rate class bundled rates in the last base rate proceeding. OSBA Cross Examination Exhibits Nos. 1 & 2. DII agrees with this approach. DII Statement No. 1-R, pp. 4-5. DLC's approach is consistent with the Act, the Universal Service Order and the PECO proceeding.

OCA (and others) propose to allocate universal service costs on other bases, including a kWh basis or a non-production allocator. See OCA Statement No. 6, pp. 47-52. These proposals are clearly contrary to the mandate in the Commission's Universal Service Order.[45] Universal Service Order, slip op. at 20. Universal service program costs cannot be allocated to customers on a per kWh basis. DII Statement No. 1-R, p. 11. In addition, Universal Service costs cannot be allocated based on the non-production demand allocator because that allocator is inconsistent with the treatment of universal service costs in Duquesne's last base rate proceeding. Id. The Commission reiterated the need for consistency with the prior rate case allocation of universal service costs in the PECO proceeding. PECO Restructuring Order, slip op. at 146.

The Commission's determination in this regard is fully supported by the Act. First, the Act prohibits inter- and intra-class cost shifting. 66 Pa. C.S. §§ 2808(a) & 2804(7). The mechanism to ensure that such cost-shifting does not occur is to maintain consistency with the allocation for these costs used in the utility's last base rate case. Id. The Commission recognized this necessity in its PECO Restructuring Order wherein it stated:

> We agree that the program costs now to be included in the USFC have previously been allocated solely to residential class. In order to avoid cost shifting, we will retain that principle.

PECO Restructuring Order, slip op. at 146.

Universal service costs are a component of current bundled rates. 66 Pa. C.S. § 2802(17). As those rates are being unbundled, the non-generation portion of the rates, including the portion devoted to universal service costs, is subject to a rate cap for 54 months to the termination of CTC recovery by the utility. Id. § 2804(4)(i)(B). All components of the capped rates are unbundled based on the

Company's cost of service study. Because universal service costs are one component of bundled rates, a specific amount is embedded in current rates for universal service costs. To increase that allocation will violate both the total rate cap and the rate cap on the individual components established under the Act. Id.[46]

In addition, assigning universal service costs predominately to the residential and general service classes is reasonable and follows sound cost of service ratemaking principles. DII Statement No. 1-R, p. 7-8. Cost of service ratemaking mandates that costs be recovered from the ratepayers for whom the costs were incurred to serve. Cost causation principles militate in favor of recovering the bulk of universal service costs should be allocated primarily to the residential and general service classes. DII Statement No. 1-R, p. 7.

In allocating universal service cost recovery, Duquesne complies with the dictates of the Act and the Commission's Orders. Arguments to allocate universal service costs on a kWh basis or a non-production demand basis should be rejected by this Commission on the same rationale stated in the Universal Service Order. Specifically, the PUC should reject these arguments as violations of the just and reasonable requirement pursuant to Section 1301, 66 Pa. C.S. § 1301, and as violations of the prohibition against cost shifting in Section 2804(7), 66 Pa. C.S. § 2804(7). DII recommends that the Company's proposed universal service cost recovery mechanism be accepted.

C. Specific Programs

DII is not addressing this issue but may respond, as appropriate, in reply brief.

D. Energy Conservation

DII is not addressing this issue but may respond, as appropriate, in reply brief.

XI. CUSTOMER EDUCATION

DII is not addressing this issue but may respond, as appropriate, in reply brief.

XII. MISCELLANEOUS ISSUES

DII addresses no "miscellaneous issues" but may respond, as appropriate, in reply brief.

XIII. CONCLUSION

The Commission is faced with critical decisions that will dictate the development of competitive markets for electric generation supply in Pennsylvania. The Commission must make these decisions with consideration of the central themes of Chapter 28 in mind. Specifically, the central themes include: the economic goals of the Governor and General Assembly in enacting Chapter 28; and, the need to balance interests of ratepayers, shareholders, utilities and all market participants in deciding transitional issues. In addition, the Commission must consider the need for consistency in decisions on many issues for the utilities in a particular region (ECAR or PJM) and statewide consistency on some issues. DII presents the best blueprint for the Commission to follow in maximizing the competitive market potential. DLC and, to a lesser extent, other parties present proposals that are to a varying extent, contrary to development of a competitive market and to enhancement of customer choice during the transition period to retail competition. DII respectfully requests that the Duquesne Restructuring Plan be modified consistent with the following recommendations:

- The Commission must adopt a definitive level of stranded costs to be recovered through DLC's CTC. The Act and precedent clearly contemplate that this issue be decided in this proceeding.
- The Commission must establish DLC's stranded generation costs as part of this proceeding. This should be done through an immediate and full divestiture of DLC's assets or application of a market price forecast. The DII forecast is reasonable and should be relied on.
- The Commission must reject DLC's delayed asset valuation proposals. In addition, DLC's range of market prices is inadequate to be relied upon in this proceeding for establishing the Company's stranded generation costs.
- The Commission should adopt DII's well reasoned and appropriate regulatory asset analysis.
- The Commission must reject DLC's future fossil decommissioning claim as contrary to Commission precedent.
- The Commission must net DLC's nuclear decommissioning claim by offsetting it against nuclear decommissioning trust fund earnings.

- Stranded costs should be shared between ratepayers and shareholders. An appropriate method for this sharing is DII's equity return disallowance applied to stranded generation costs.

- DLC should pursue securitization of its authorized stranded costs as a final mitigation effort.

- The Commission must adopt the DII recommended "CTC residual" methodology. This methodology properly assigns stranded cost responsibility and will encourage the development of the competitive market.

- The Commission must reject DLC's proposed tariff change to limit the availability of Interruptible Service and Time of Day Service.

- The Commission must mandate that DLC unbundle "Rule 4" contracts to allow customers access to the competitive market.

- The Commission must mandate that DLC continue to offer economic development incentive rates to current customers through the transition period.

- The Commission must reject DLC's attempt to inappropriately inflate its monopoly transmission and distribution rates through the use of the Company's "required" rate of return and the inclusion of distribution losses and certain generation-related ancillary services in those rates.

- The Commission must adopt DII's accelerated phase-in proposal, in which oversubscription for any stage of direct access phase-in results in a pro-rata reduction of competitive load for all customers desiring participation in that phase.

WHEREFORE, the Duquesne Industrial Intervenors respectfully requests that the Commission modify Duquesne Light Company's restructuring plan consistent with the foregoing arguments.

Respectfully submitted,

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Dated: February 10, 1998

ENDNOTES

1. The General Assembly and the Governor wisely recognized that by taking the lead among the states in the country and offering the consumers in Pennsylvania the choice of electricity suppliers, much of the price disparity that currently exists among rate charged by the various Pennsylvania utilities and between the rates charged by Pennsylvania utilities compared to the national averages could be eliminated. 66 Pa. C.S. §§ 2802(4) & (5). The elimination of this disparity, and the resulting availability of lower cost electricity supplies to businesses that operate in Pennsylvania or are considering operating in Pennsylvania will have beneficial effects on the economic growth and vitality of the Commonwealth. Id. § 2802(6) & (7). These economic growth goals must underlie the Commission's decisions with respect to Duquesne's restructuring plan.

2. The Commission has two main sources of guidance for its decisions with respect to Duquesne's restructuring plan. First, the Commission must interpret the letter and the spirit of the Act. 66 Pa. C.S. § 2801, et seq. The Act is very specific with respect to how the benefits of competition and deregulation are to be provided to the consumers of Pennsylvania. It requires that all decisions made by the Commission with respect to Duquesne's restructuring filing take into account a balancing of ratepayer, investor, utility, and competitor interests. Id. § 2804(14). In addition, the Commission is required to accomplish restructuring in a manner that does not unreasonably discriminate against any customer class and does not effect intra-class or inter-class cost shifting. Id. §§ 2804(7) & 2808(a). Utilities are permitted to recover qualifying "stranded costs;" however, during the period of collection of the stranded costs and as a quid pro quo for the payment by ratepayers of the stranded costs, customers in the host utility service areas are provided with a rate cap on total charges and individual components of the total charge. Id. § 2804(4)(i) & (ii).

A second source of guidance for the Commission is prior Orders implementing the Act. Many issues before the Commission in this proceeding are not now issues of first impression. The Commission has previously issued Orders and Opinions with respect to the PECO Energy Company ("PECO") qualified rate order request, Application of PECO Energy Company for Issuance of a Qualified Rate Order Under Sections 2808 and 2812 of the Public Utility Code, Docket No. R-00973877, Opinion and Qualified Rate Order entered on May 22, 1997, 177 PUR 4th 417 (1997) (hereinafter "PECO QRO Order"), and the PECO restructuring proceeding, Application of PECO Energy Company for Approval of Its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement & Petition of Enron Energy Services Power, Inc., for Approval of an Electricity Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(c) at the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order entered on December 23, 1997, Order on Reconsideration entered on January 16, 1998 ("PECO Reconsideration Order") (attached in Appendix D). In addition, the Commission has issued orders in various generic dockets regarding issues such as universal service and conservation programs and funding. Guidelines for Universal Servicing Energy Conservation Programs Made Pursuant to 66 Pa. C.S. § 2803, § 2802(17), 2804(8) and 2804(9), Docket No. M-960890F00010, Final Order entered on July 11, 1997 ("Universal Service Order"). The fairness and balancing of interests required under the Act mandates that the Commission consistently apply decisions made in its previous orders regarding restructuring issues. See 66 Pa. C.S. § 2802(8). The competitive advantages that could accrue to one utility over another utility by inconsistency in the Commission's decisions on issues, such as the proper method of stranded cost calculation, could irreparably impede the competitive environment that the Act seeks to introduce. Moreover, a lack of consistency could lead to the situation that the Act intends to remedy and continue the significant differences in price and level of service offered to consumers in the various service territories in the Commonwealth. See Id. § 2802(4).

3. DII is an ad hoc association of Duquesne's largest industrial and institutional customers. DII members use approximately 1.8 billion kWh of electricity per year. DII members take service primarily on Duquesne's rate schedules HVPS, L, GM, and GL and various service riders and contract rates. A list of DII members, for purposes of this proceeding, is on the cover of this brief.

4. The Act mandates that a maximum of 33% of the peak load of each customer class must have the opportunity for direct access on January 1, 1999; 66% must have the opportunity for direct access on January 1, 2000; and, all customers must have the opportunity for access on January 1, 2001. 66 Pa. C.S. § 2806(b). As recognized by the Act, competitive disadvantages may be created by direct competitors in the same industry not having simultaneous access to the competitive market (and presumably cheaper electricity). Id. § 2806(b)(4).

5. According to the DLC proposal, customers in particular SIC codes will be phased-in to the appropriate stage of direct access as groups until the applicable 33% or 66% threshold is reached, even if the last sic code permitted access exceeds the threshold. Tr. at 1027.

6. This schedule is permissible under Section 2806 of the Act that establishes the following phase-in schedule (66 Pa. C.S. § 2806(b)):

(1) As of January 1, 1999, a maximum of 33% of the peak load of each customer class shall have the opportunity for direct access.

(2) As of January 1, 2000, a maximum of 66% of the peak load of each customer class shall have the opportunity for direct access.

(3) As of January 1, 2001, all customers of electric distribution companies in the Commonwealth shall have the opportunity for direct access.

7. All parties to this proceeding agree that the generation component of the rate is determined by taking the bundled capped rate and subtracting transmission and distribution charges. See generally DII Statement No. 1, p. 36; Duquesne Statement No. 5, pp. 47-69; OCA Statement No. 4, pp. 13-15.

8. If the OCA CTC methodology is accepted, the change in the generation component will affect the competitive generation credit ("CGC"), which in turn will determine whether customers can economically participate in the competitive market.

9. The DII unbundling analysis submitted in this proceeding for the RS, L, and HVPS rates use DLC's realized rate of return, rather than the "required" rate of return. See DII Statement No. 1, pp. 46-47, Exhibits Nos. SJB-7, SJB-8 & SJB-9.

10. For example, to supply 100 kWh to a customer, if a utility experiences a 5% average line loss the generator must produce 105 kWh. See OCA Statement No. 4, p. 5.

11. DII's unbundling analysis for rates R, L, and HVPS appropriately includes so-called distribution losses as part of the generation function. See DII Statement No.1, pp. 46-47, Exhibits Nos. SJB-7, SJB-8 & SJB-9.

12. The ancillary services at issues are: scheduling, system control and dispatch; reactive supply and voltage control from generating sources; regulation and frequency response; energy imbalance; operating spinning reserves; and, operating supplemental reserves. Duquesne Statement No. 5, p. 19.

13. Ultimately, all provisions of the Public Utility Code must be read together to govern the Commission's decision in this proceeding, including Chapter 28 (relating to the introduction of competition for electric generation supply) and Section 1301 (relating to the Commission's duty to ensure just and reasonable rates).

14. The legal and policy reasons for a one-time determination of stranded costs as of December 31, 1998, are discussed in detail in Section IV.B.3.a., infra.

15. This offer is contingent on the proposed merger with APS being rejected. Tr. at 24.

16. $944.969 million - $232.289 million = $712.68 million.

17. In order to be properly claimable as a stranded generation cost, the cost must be included in a category established in the Act, which include:

(1) Net plant investments and costs attributable to existing generation plant and facilities;

(2) Disposal of spent nuclear fuel;

(3) Long-term power purchase commitments other than non-utility generator contracts;

(4) Retirement costs not included in net plant investments; and,

(5) Transition costs such as employee severance.

66 Pa. C.S. § 2803. The utility's costs must also meet the general criteria to be claimed under the definition: the costs must be known and measurable; the costs must have been prudently incurred and not previously disallowed by the Commission; and, the costs must remain after mitigation. Id.

18. As explained previously, stranded costs must meet the follow requirements in order to be properly quantified under the Act: (a) the cost is known and measurable; (b) the cost is typically recoverable in a regulated environment, but will not be recovered in competitive market; (c) the amount of the cost is determined on a NPV basis over the life of the asset; and, (d) the cost is netted against any benefits from the movement to a competitive market. 66 Pa. C.S. § 2803.

19. The Act defines transition or stranded cost as follows:

> An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the Commission determines will remain following mitigation by the electric utility.

66 Pa. C.S. § 2803 (emphasis added).

20. The Act also states that the Commission may take into account past mitigation efforts by the utility. 66 Pa. C.S. § 2808(c)(4).

21. The general steps in this analysis are as follows:

(1) Project price of electricity in competitive market;

(2) Determine revenues for generating units based on projected market price and expected kWh output;

(3) Determine market value of assets based on projected revenues minus variable operating expenses;

(4) Determine stranded cost based on comparison of market value to book value;

(5) Apply PUC jurisdiction percentage; and,

(6) Discount to present value.

Id. These steps equate to the general process that a willing buyer would undertake before purchasing Duquesne's assets.

22. DII explains the KPC model as follows:

Q. Please describe what you mean by a probabilistic modeling.

A. Random forced outages of large generating units can result in substantial increases in marginal generation costs as higher cost intermediate and peaking units are dispatched to serve load. A probabilistic simulation computes the expected value of production costs (both total and marginal costs) by computing the probability weighted average of all possible generator outages. The methodology used to calculate probabilistic production cost results are described in technical publications. A Monte Carlo simulation performs the same calculation by developing a series of simulations of a large number of possible outage states and computes the average result from these trials. Both techniques can be equally accurate. Probabilistic techniques are computationally more efficient, but generally require creation of a load duration curve and therefore lose the chronological character of the system dispatch that is more important for modeling of pumped storage, for example. Monte Carlo techniques are not as efficient, and the operation of individual steam plants is more difficult to capture. In my simulations, I use the Probabilistic model to compute revenues and market prices for all plants except pumped storage units for which I use the Monte Carlo model.

* * *

Q. Please describe the Monte Carlo model.

A. This program models the economics of pumped storage plants using a probabilistic (Monte Carlo) technique and the same data base as the basic probabilistic model, but with a higher level of detail. The model enables one to estimate hourly marginal costs for a given region. It then makes the economic determination of whether to utilize a pumped storage unit on a given day based on the ability to offset high cost generation during peak hours with lower cost energy (recognizing pumping losses) during the off-peak period. The model maintains the chronology of daily loads and enables a more realistic modeling

> of pumped storage plants than other resources. The model outputs are then used to develop an input load shape for the Probabilistic model and provides estimates of the profitability of pumped storage plants.

DII Statement No. 2, pp. 35-36 & 38-39.

23. Duquesne's range of market prices does not fully model any market. DII Statement No. 2, p. 15.

24. As DII explains,

> I have consistently used $595/kW for a combined cycle unit and $300/kW for a new oil-fired CT. In the PECO Securitization proceeding, PECO's witness, Dr. Hieronymus, initially estimated a cost of $655/kW for a CC and $360/kW for a gas-fired CT. While Dr. Hieronymus did initially reduce his cost estimates in the PECO restructuring (to $519/kW), it is my understanding that in producing his rebuttal testimony, Dr. Hieronymus once again increased his CC and CT cost estimates. Further, in the PECO case, another PECO witness, Mr. Bustard, estimated a cost of $625/kW for new combined cycle plants. In the PP&L case, PP&L's witness, Dr. Jones, assumed that new combined cycle plants would cost $595/kW and new gas-fired CTs would cost $338/kW in his EGAS simulations. Finally, in the GPU case, GPU's witness, Mr. Roberts, estimated the new CC's would cost $490/kW while a dual-fuel CT would cost $350/kW.

DII Statement No. 2, pp. 25-26.

25. DII also uses the forecast to determine the CTC. Issues surrounding the use of market prices for determining CTCs are discussed in Section V, infra.

26. Duquesne provides a range of projected market prices and a resulting range of stranded costs based on a range of long run marginal costs for new market entry. Duquesne Statement No. 3, p. 27, Exhibit MMS-2. This analysis must be discarded. First, the analysis does not offer the level of complexity and detail necessary for the Company to fulfill its burden of proof. DII Statement No. 2, p. 22. Second, DLC's combination of high and low scenarios for the inputs is flawed — it is illogical to believe, as DLC does, that all low or high variables will occur simultaneously. Id. Other flaws are detailed in DII testimony. See Id. at 13-33.

27. Duquesne's second approach still depends, in some part, on an arbitration panel. Duquesne Statement No. 2-R, pp. 3-4. If for some reason the Commission did not order complete generation assets divestiture, an arbitration panel would determine the future market value and stranded costs for any remaining assets. As previously explained, the use of an arbitration panel for any part of this determination is inappropriate.

28. The Company has repeatedly asserted the need for this proceeding to be considered on a stand alone basis. See e.g. Tr. at 24-25.

29. DII describes the Company's nuclear decommissioning recovery proposal as follows:

> The Company's request for nuclear decommissioning costs consists of two components tied to its two part stranded cost CTC recovery proposal. The first component consists

of Beaver Valley 1 and 2 and Perry decommissioning accruals which under DLC's proposal, are continued at currently authorized levels and then summed for the seven years of CTC recovery.

The second component is the net present value at December 31, 2005 of the additional nuclear decommissioning accruals remaining after summing the seven years of CTC recovery at current recovery levels.

DII Statement No. 3, p. 31.

30. Prospective fossil decommissioning expenses are not recoverable under traditional rate making or as a stranded cost, because they are not "known and measurable" without a specific plan to decommission a particular plant at a particular time and in a particular manner. At this point in time, the record contains no evidence that any particular existing fossil plant will in fact have to be decommissioned at all, when such decommissioning might occur, the extent of decommissioning that will be required, the future use of the plant and its site, or the cost of the decommissioning found to be needed. At this point in time, no one knows whether a generation plant will require total dismantling to "greenfield" status or some other less expensive level of dismantling. Depending on the future use, existing plants connected to the transmission system and their sites may have a significant residual "salvage" value, partly offsetting, or even surpassing any cost of decommissioning.

PECO Restructuring Order, slip op. at 92.

31. Regulatory assets are past costs incurred by regulated utilities that the Commission has specifically stated the utility can recover from ratepayers in the future. Duquesne Statement No. 4, p. 5.

32. Duquesne claims other regulatory assets in this proceeding that are not addressed by DII. DII does not support DLC's request or calculation of those claims. DII Statement No. 3, p. 6.

33. As explained in Section IV.B.1, supra, the Company's proposal to delay stranded cost determination is not permissible under the Act and is contrary to the balancing required in transition issue decisions.

34. The Company, through Mr. Clayton, simply agreed that it hadn't quantified the nominal value at December 31, 1998 correctly (refer to Mr. Clayton's Exhibit DJC-14) and reduce its claim by $0.5 million. However, the Company failed to respond to the fact that it is not entitled to earn a rate of return on the deferred balance of the regulatory asset. Instead, Mr. Clayton argued that the Company had excluded the nominal amount from rate base. Unfortunately, the exclusion from rate base was not for stranded cost quantification purposes, but only for the Company's revenue requirement computations. Consequently, its stranded cost claim remains overstated at the nominal value and must be restated to the present value I recommended in my direct testimony.

Id.

35. The Company's claim for deferred injuries and damages reflects a difference in the accounting treatment for costs related to workers' compensation liability as required by the Commission for rate making purposes and as required under financial accounting purposes. Duquesne Statement No. 4, p.

11. The Company's claim for deferred compensated absences reflects Duquesne's "accrued liability for its employee's right to receive compensation for future absences when that compensation is attributable to service already rendered." Id. at p. 12. Duquesne must book both expenses on an accrual basis for accounting purposes, but only recover on a cash pay-as-you-go basis in rates. Id.

36. The Company claims that this regulatory asset is created by a change in accounting. In support of the proposed change, the Company references an opinion letter from its outside auditors confirming that a similar change in accounting would be appropriate for its fossil units in 1993. Duquesne Statement No. 2-R, p. 29. Company reliance on the opinion letter is misplaced because that letter was issued with respect to the accounting for these costs in the regulated environment; the Company has not obtained a letter indicating that this accounting treatment will still be appropriate in the deregulated environment. DII Statement No. 3-S, pp. 13-14.

37. The Customer Advanced Reliability System or "CARS" provides time differentiated pricing capability for all customers. See Duquesne Statement No. 8, pp. 3-7.

38. The methodology for determining CTCs will be discussed in detail in Section V, infra.

39. The three-step process is as follows:

- The Commission must determine whether the components of the claim are properly claimed under the Act.
- The Commission must determine the correct quantification of the properly claimed stranded costs.
- The Commission must determine a just and reasonable level of claimed and quantified stranded costs that are properly recoverable from ratepayers.

40. Historically, in rate proceedings in which economic excess capacity has been an issue, the analysis compared embedded cost to the opportunity cost associated with a more economic alternative. For example, the life cycle cost of a nuclear unit would be compared to the life cycle cost of a combustion turbine to determine the present value "excess" costs associated with the investment in the nuclear unit. An economic excess capacity adjustment would then be based on the disallowance of all or a portion of the uneconomic amount of the investment being considered for ratemaking.

* * *

...The main difference in the stranded cost analysis is that the opportunity cost is the market price. In other words, a comparison is made between the cost of an investment (including operating cost) and the alternative or opportunity cost associated with market based pricing. In this manner, a stranded cost analysis is similar to an economic excess capacity analysis. DII's proposed sharing mechanism recognizes this underlying similarity and has relied on the used and useful standard as well as the Competition Act to arrive at a reasonable basis for sharing the stranded cost associated with DLC's generating units.

DII Statement No. 1-S, pp. 8-9.

41. As stated in the PECO restructuring decision:

> [I]n order to recover each component of the requested amount, [the utility] has the burden to prove, based on substantial evidence in the record, that each request would recover the net present value of the unmitigated, net, known and measurable generation related expense within the definition of stranded costs. [The utility] has the burden to prove that such costs would have been recoverable under traditional regulation but will not be recoverable in a competitive market. Once identified as appropriately recoverable stranded costs, the Commission must determine a just and reasonable amount authorized for recovery.

PECO Restructuring Order, slip op. at 68.

42. The Act states as follows:

> The costs to be recovered should be allocated to customer classes in a manner that does not shift interclass or intraclass costs and maintains consistency with the allocation methodology for utility production plan accepted by the Commission in the electric utility's most recent base rate proceeding.

66 Pa. C.S. § 2808(a) (emphasis added).

43. First, the calculation would allocate the stranded cost responsibility to each rate class on the basis of the production capacity allocated. OCA Statement No. 4, p. 9. That allocation would then be recovered on a levelized basis throughout the transition period. Id. at 14.

44. DLC's proposal may also impact decisions regarding the expansion of current facilities if the discount on incremental load is not available.

45. The Universal Service Order states:

> Several commentators support a kWh assessment on all customer classes. We cannot accept this recommendation because it places a disproportionate responsibility for funding universal service and energy conservation programs on high kWh (high volume) users in violation of Section 1301. Further the Act at § 2804(7) prohibits interclass and intraclass cost shifting. Assessing a funding mechanism on kWh use is inconsistent with rate treatments for these programs in recent base rate cases.

46. The overall rate cap (66 Pa. C.S. § 2804(4)) and the prohibition against cost shifting (66 Pa. C.S. §§ 2808(a) & 2804(7)) logically create a cap on the individual rate components at their January 1, 1997, levels. It is simply not possible to change the individual allocation currently within rates without violating one provision or the other. An increase in one allocation will either result in the exceedence of the rate cap or the need to reduce some other component of the formerly bundled rate. The reduction in that component must be shifted to another rate class if the Company is to recover its full cost of service.

APPENDIX A

REQUIRED SUMMARY TABLES

Duquesne Light Company
Summary of DII Recommended Stranded Costs
($000)

	Company Claim	DII Adjustments	DII Recommendation/ Adjusted Amount
Nuclear	$934,390	(165,066) [1]	$769,324
Fossil	$607,260	(337,753)	$269,507
Regulatory Assets	$489,820	94,990 [1]	$584,810
Total Net Present Value (NPV) in 1999 $	$2,031,470	(407,829)	$1,623,641
PUC NPV in 1999$			$1,622,169 [2]
PUC Jurisdictional Percent			99.909%

All items are stated on a pre-tax basis.

[1] A portion of these adjustments are due to the treatment of the Beaver Valley 2 lease expense. DII includes a portion of the Beaver Valley 2 lease expense in Regulatory Assets, while DLC includes all of the lease expense in Nuclear Generating stranded costs.

[2] In order to produce a just and reasonable level of stranded costs to be recovered from ratepayers, DII proposes an "equity return disallowance" which would reduce the Total Net Present Value in 1999 $ by $232,500,000 to $1,391,141,000. Tables in Appendix B and C contain a full presentation of the DII position including the equity return disallowance.

Duquesne Light Company
DII Recommended Stranded Cost Calculation - Nuclear
($000)

	Company Claim	DII Adjustments	DII Recommendation/ Adjusted Amount
a. Net Book Value	$788,590	(291,220)	$497,370 [1]
b. (Market Value)	($7,200)	236,195	$228,995 [2]
c. PV of Nuclear Decommissioning	$57,400	(14,441)	$42,959 [3]
d. PV of Costs Independent Operation	$95,600	n/a [4]	n/a [4]
e. **Net Present Value (NPV) in 1999 $ (a+b+c+d)**	$934,390	(165,066)	$769,324 [5]
Discount Rate	7.83%	-	7.83%
PUC Jurisdictional Percent	99.93%	-0.021%	99.909%

All items are stated on a pre-tax basis.

[1] DII Statement No. 1, p. 10; Duquesne Statement No. 2-R, Exhibit No. DJC-21.
[2] DII Statement No. 2, Exhibit No. RJF-5.
[3] DII Statement No. 3, p. 31-33, Exhibit No. LK-5.
[4] These costs, net of incremental margins, were separated out by DLC in its rebuttal testimony. DII includes these costs and margins as part of the calculation of Market Value. Tr. at 547-551.
[5] DII proposes an equity return disallowance which would reduce the Nuclear Generation Stranded Costs by $165,580,000 to $599,744,000. See the tables in Appendix B for a full presentation of the DII position including the equity return disallowance.

Duquesne Light Company
DII Recommended Stranded Cost Calculation - Fossil
($000)

	Company Claim	DII Adjustments	DII Recommendation/ Adjusted Amount
a. Net Book Value	$448,360	33,400	$481,760 [1]
b. (Market Value)	($20,200)	(192,053)	($212,253) [2]
c. PV of Fossil Decommissioning	$66,500	(66,500)	$0 [3]
d. PV of Costs Independent of Operation	$112,600	n/a [4]	n/a [4]
e. **Net Present Value (NPV) in 1999$ (a + b + c + d)**	$607,260	(337,753)	$269,507 [5]
Discount Rate	7.83%	-	7.83%
PUC Jurisdictional Percent	99.93%	-0.021%	99.909%

All items are stated on a pre-tax basis.

[1] DII Statement No. 1, p. 10; Duquesne Statement No. 2-R, Exhibit No. DJC-21.
[2] DII Statement No. 2, Exhibit No. RJF-5.
[3] DII Statement No. 3, pp. 26-30; DII Statement No. 3-S, pp. 24-25.
[4] These costs, net of incremental margins, were separated out by DLC in its rebuttal testimony. DII includes these costs and margins as part of the calculation of Market Value. Tr. at 547-551.
[5] DII proposes an equity return disallowance which would reduce the Fossil Generation Stranded Costs by $62,920,000 to $206,587,000. See the tables in Appendix B for a full presentation of the DII position including the equity return disallowance.

Duquesne Light Company
DII Recommended Stranded Cost Calculation
Regulatory Assets
($000)

	Company Claim [1]	DII Adjustments	DII Recommendation/ Adjusted Amount[2]
a. Regulatory Tax Receivable	236,480	0	236,480
b. Post-2005 Unamortized Debt Costs	34,230	-34,230	0
c. Pre-2006 Unamortized Debt Costs	16,760	-16,760	0
d. Deferred Rate Synchron Costs	33,430	-8,560	24,870
e. Deferred Employee Costs	17,800	-17,800	0
f. Deferred Nuclear Maintenance	3,250	0	3,250
g. DOE Decommissioning	7,180	0	7,180
h. Deferred Coal Costs	13,500	-13,500	0
i. Deferred Caretaker Costs	6,770	-6,770	0
j. BV2 Training Costs	2,420	0	2,420
k. Low Level Radioactive Waste	2,270	0	2,270
l. Coal Cost Equalization	120	0	120
m. Pre-Accrued Nuclear Outages	22,650	-22,650	0
n. FAS 106 Deferral	4,220	-4,220	0
o. Deferred Fuel Costs	14,810	0	14,810
p. Other Regulatory Assets			
1. Beaver Valley Lease	0	227,780	227,780
2. Other	700	0	700
q. BV2 Sale/Leaseback Premium			0
r. Gain on Sale/Leaseback Tax Effect	55,130	0	55,130
s. Deferred Rate Synchr Tax Effect			n/a [3]
t. Beaver Valley 2 Tax Effect			n/a [4]
u. SFAS 109 Plant	0	0	0
v. Other Transition Expenses	18,100	-8,300	9,800
w. Net Present Value (NPV) in 1999 $ (Sum of a. to v.)	489,820	94,990	584,810
PUC Jurisdictional Percent	99.93%	-0.021%	99.909%

Notes:

All items are stated on a pre-tax basis.

[1] The Company's claim amounts are based upon Exhibit DJC-10 filed by the Company in the Rebuttal Phase of this proceeding. The amounts on Exhibit No. DLC-10 are stated on an after tax basis. DII relied on Exhibit No. DLC-15 for the comparable pre-tax amounts.

[2] DII Statement No. 3, pp. 6-25; DII Statement No. 3-S, pp. 6-23.

[3] Treated as part of "Deferred Rate Synchronization Costs" regulatory asset listed at f. above.

[4] Treated as part of "Other" regulatory assets listed at p.2. above.

APPENDIX B

SUMMARY TABLES INCLUDING EQUITY RETURN DISALLOWANCE

Duquesne Light Company
Summary of DII Recommended
Stranded Costs Including Equity Return Disallowance
($000)

	Company Claim	DII Adjustments	DII Recommendation/ Adjusted Amount
Nuclear	$934,390	(334,646) [1]	$599,744
Fossil	$607,260	(400,673)	$206,587
Regulatory Assets	$489,820	94,990 [1]	$584,810
Total Net Present Value (NPV) in 1999 $	$2,031,470	(640,329)	$1,391,141
PUC NPV in 1999$			$1,389,879
PUC Jurisdictional Percent			99.909%

All items are stated on a pre-tax basis.

[1] A portion of these adjustments are due to the treatment of the Beaver Valley 2 lease expense. DII includes a portion of the Beaver Valley 2 lease expense in Regulatory Assets, while DLC includes all of the lease expense in Nuclear Generating stranded costs.

Duquesne Light Company
DII Recommended Stranded Cost Calculation - Nuclear
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d. PV *of Costs Independent* Operation	$95,600	n/a	n/a [4]
e. **Net Present Value (NPV) in 1999 $ (a+b+c+d)**	$934,390	(165,066)	$769,324
f. Equity Return Disallowance	$0	(169,580)	($169,580) [5]
g. **Net Present Value (NPV) in 1999 $ with Disallowance (e+f)**	$934,390	(334,646)	$599,744
Discount Rate	7.83%	-	7.83%
PUC Jurisdictional Percent	99.93%	-0.021%	99.909%

All items are stated on a pre-tax basis.

[1] DII Statement No. 1, p. 10; Duquesne Statement No. 2-R, Exhibit No. DJC-21.
[2] DII Statement No. 2, Exhibit No. RJF-5
[3] DII Statement No. 3, pp. 31-33, Exhibit No. LK-5.
[4] These costs, net of incremental margins, were separated out by DLC in its rebuttal testimony. DII includes these costs and margins as part of the calculation of Market Value. Tr. at 547-551.
[5] DII Statement No. 1, pp. 9-12, Exhibit No. SJB-3.

APPENDIX B
Table 3

Duquesne Light Company
DII Recommended Stranded Cost Calculation - Fossil
($000)

	Company Claim	DII Adjustments	DII Recommendation/ Adjusted Amount
a. Net Book Value	$448,360	33,400	$481,760 [1]
b. (Market Value)	($20,200)	(192,053)	($212,253) [2]
c. PV of Fossil Decommissioning	$66,500	(66,500)	$0 [3]
d. PV of Costs Independent Operation	$112,600	n/a	n/a [4]
e. **Net Present Value (NPV) in 1999 $ (a+b+c+d)**	$607,260	(337,753)	$269,507
f. Equity Return Disallowance	$0	(62,920)	($62,920) [5]
g. **Net Present Value (NPV) in 1999 $ with Disallowance (e+f)**	$607,260	(400,673)	$206,587
Discount Rate	7.83%	-	7.83%
PUC Jurisdictional Percent	99.93%	-0.021%	99.909%

All items are stated on a pre-tax basis.

[1] DII Statement No. 1, p. 10; Duquesne Statement No. 2-R, Exhibit No. DJC-21.
[2] DII Statement No. 2, Exhibit No. RLF-5.
[3] DII Statement No. 3, pp. 26-30; DII Statement No. 3-S, pp. 24-25.
[4] These costs, net of incremental margins, were separated out by DLC in its rebuttal testimony. DII includes these costs and margins as part of the calculation of Market Value. Tr. at 547-551.
[5] DII Statement No. 1, pp. 9-12, Exhibit No. SJB-3.

Duquesne Light Company
DII Recommended Stranded Cost Calculation
Regulatory Assets
($000)

	Company Claim [1]	DII Adjustments	DII Recommendation/ Adjusted Amount[2]
a. Regulatory Tax Receivable	236,480	0	236,480
b. Post-2005 Unamortized Debt Costs	34,230	-34,230	0
c. Pre-2006 Unamortized Debt Costs	16,760	-16,760	0
d. Deferred Rate Synchron Costs	33,430	-8,560	24,870
e. Deferred Employee Costs	17,800	-17,800	0
f. Deferred Nuclear Maintenance	3,250	0	3,250
g. DOE Decommissioning	7,180	0	7,180
h. Deferred Coal Costs	13,500	-13,500	0
i. Deferred Caretaker Costs	6,770	-6,770	0
j. BV2 Training Costs	2,420	0	2,420
k. Low Level Radioactive Waste	2,270	0	2,270
l. Coal Cost Equalization	120	0	120
m. Pre-Accrued Nuclear Outages	22,650	-22,650	0
n. FAS 106 Deferral	4,220	-4,220	0
o. Deferred Fuel Costs	14,810	0	14,810
p. Other Regulatory Assets			
1. Beaver Valley Lease	0	227,780	227,780
2. Other	700	0	700
q. BV2 Sale/Leaseback Premium			0
r. Gain on Sale/Leaseback Tax Effect	55,130	0	55,130
s. Deferred Rate Synchr Tax Effect			n/a [3]
t. Beaver Valley 2 Tax Effect			n/a [4]
u. SFAS 109 Plant	0	0	0
v. Other Transition Expenses	18,100	-8,300	9,800
w. Net Present Value (NPV) in 1999 $ (Sum of a. to v.)	489,820	94,990	584,810
PUC Jurisdictional Percent	99.93%	-0.021%	99.909%

Notes:

All items are stated on a pre-tax basis.

[1] The Company's claim amounts are based upon Exhibit DJC-10 filed by the Company in the Rebuttal Phase of this proceeding. The amounts on Exhibit DJC-10 are stated on an after tax basis. DII relied on Exhibit No. DJC-15 for the comparable pre-tax amounts.

[2] DII Statement No. 3, pp. 6-25; DII Statement No. 3-S, pp. 6-23.

[3] Treated as part of "Deferred Rate Synchronization Costs" regulatory asset listed at f. above.

[4] Treated as part of "Other" regulatory assets listed at p.2. above.

APPENDIX C

DII STRANDED COST RECOMMENDATION: SUMMARY OF ADJUSTMENTS

DII STRANDED COST RECOMMENDATION
Summary of Adjustments

	Company Claim	DII Adjusted Amount
Recoverable Regulatory Assets		
Regulatory Tax Receivable	236,480	236,480
Post-2005 Unamortized Debt Costs	34,230	0
Pre-2006 Unamortized Debt Costs	16,760	0
Deferred Rate Synchron Costs	33,430	24,870
Deferred Employee Costs	17,800	0
Deferred Nuclear Maintenance	3,250	3,250
DOE Decommissioning	7,180	7,180
Deferred Coal Costs	13,500	0
Deferred Caretaker Costs	6,770	0
BV2 Training Costs	2,420	2,420
Low Level Radioactive Waste	2,270	2,270
Coal Cost Equalization	120	120
Pre-Accrued Nuclear Outages	22,650	0
FAS 106 Deferral	4,220	0
Deferred Fuel Costs	14,810	14,810
Other Regulatory Assets		
BV Lease	0	227,780
Other	700	700
BV2 Sale/Leaseback Premium	0	0
Gain on Sale/Leaseback Tax Effect	55,130	55,130
Deferred Rate Synchr Tax Effect	0 n/a	
Beaver Valley 2 Tax Effect	0 n/a	
SFAS 109 Plant	0	0
Other Transition Expenses	18,100	9,800
Subtotal	489,820	584,810
Offsetting Regulatory Liabilities	0	0
Subtotal of Regulatory Assets and Liabilities	489,820	584,810
Non-Utility Generating Contracts	0	0
Nuclear Decommissioning Expense	57,400	42,959
TOTAL Section 2808(c)(1) and (2) STRANDED COSTS	547,220	627,769
Utility Generation		
Book Value	1,236,950	979,130
Less: Market Value	-180,800	-16,742
Total Stranded Generation Costs	1,417,750	995,872
Fossil Decommissioning Expense	66,500	0
Other Transition Costs		
Disallowance	0	-232,500
TOTAL RECOVERABLE STRANDED COSTS	2,031,470	1,391,141
PUC Jurisdictional Amount		1,389,879

APPENDIX D

PECO RESTRUCTURING RECONSIDERATION ORDER

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held January 15, 1998

Commissioners Present:

John M. Quain, Chairman , Joint Concurring & Dissenting Statement attache
Robert K. Bloom, Vice Chairman, Joint Concurring & Dissenting Statement attache
John Hanger
David W. Rolka
Nora Mead Brownell

Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement	R-00973953
Petition of Enron Energy Services Power, Inc., for Approval of an Electric Competition and Choice Plan and for Authority Pursuant to Section 2807(e)(c) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company	P-00971265

OPINION AND ORDER

(Restructuring Reconsideration Order)

BY THE COMMISSION:

By Motion adopted on December 11, 1997, and by Opinion and Order entered on December 23, 1997, this Commission approved a Restructuring Plan for PECO Energy Company (PECO) based upon modifications to PECO's original Application in this proceeding. Presently before this Commission for review are six (6) Petitions for Reconsideration, Clarification, and/or Amendment of the December 23, 1997 Order individually filed on January 7, 1998, by: (1) PECO, (2) Enron Energy Services Power, Inc., and Enron Power Marketing, Inc., (individually: EESPI and EPMI, or collectively: Enron) (Enron Petition), (3) the Office of Consumer Advocate (OCA), (4) the Consumer Education and Protective Association (CEPA), the Tenant Action

Group (TAG), the Association of Community Organizations for Reform Now (ACORN), and John W. Long, (collectively: CEPA) (CEPA Petition), (5) the Philadelphia Area Industrial Energy Users Group (PAIEUG), and (6) New Energy Ventures (NEV).

Brief History of the Proceedings[1]

Effective January 1, 1997, the Electricity Generation Customer Choice and Competition Act (Act), 66 Pa. C.S. §§2801, et seq., amended the Public Utility Code (Code), 66 Pa. C.S. §§101, et seq., by adding Chapter 28. Chapter 28 restructured the provision of retail electric service within the Commonwealth. Section 2806 of the Act requires all jurisdictional electric utilities (EDCs) to file restructuring plans for review and approval by the Commission. The Act established a nine-month review process for an EDC's restructuring plan. On January 24, 1997, at Docket No. M-00960890, F0005, this Commission established a schedule for filing restructuring plans. On February 13, 1997, the Commission directed that all restructuring plan filings be accompanied by specific data. (Retail Access Pilot Program - Guidelines, Docket No. M-00960890, F0003).

On April 1, 1997, PECO filed the subject Application for Approval of its Restructuring Plan. PECO's Restructuring Plan requested that this Commission approve its proposed unbundling of rates, competitive transition charges (CTCs), and specific tariff provisions to ensure customers have direct access to all licensed electric generation suppliers. Further, PECO requested recovery of $6.8 billion of transition and stranded costs. Finally, PECO asked for approval of a plan to meet its universal service obligations, of a mechanism to recover the costs of its universal service obligations, and of a proposed consumer education program.

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[1] This section is adapted in large measure from this Commission's December 23, 1997 Order in these proceedings. For a detailed history of the proceedings, see that Order.

The proceeding was assigned to Administrative Law Judges (ALJs) Marlane Chestnut and Charles Rainey. Rate protests were filed by various parties. The OCA, the Office of Small Business Advocate (OSBA), and this Commission's Office of Trial Staff (OTS) entered appearances. Formal Complaints were filed by CEPA, TAG, the Action Alliance of Senior Citizens (AASC), Mr. Long, PAIEUG, and ACORN. The AASC subsequently withdrew its Complaint.

Intervenors included the Hon. Vincent J. Fumo, Jr., Senator, 1st State Senatorial District (Sen. Fumo), Indianapolis Power and Light Co. (IPL), the Environmentalists,[2] Delmarva Power and Light Co., t/d/b/a Conectiv Energy (Conectiv), Enron Corp. (an affiliate of EESPI and EPMI), DuPont Power Marketing (DuPont), the Mid-Atlantic Power Supply Association (MAPSA), the Delaware Valley Schools Energy/Utility Consortium (DVSEUC), Allegheny Power Company (APC), American Energy Solutions (AES), the Department of the Navy (Navy), the American Association of Retired Persons (AARP), Lance Haver, CNG Energy Services (CNG), the Municipal Intervenors Group (MIG), NEV, the Pennsylvania Petroleum Association (PPA), Ethan Giddings, the Center for Energy and Economic Development (CEED), Duke Energy Trading Market, LLC, (Duke), the Pennsylvania Retailers' Association (PRA), NorAm Energy Management, Inc. (NorAm), Vastar Power Marketing, Inc. (Vastar), Electric Clearinghouse, Inc. (ECI), ERI Services, Inc. (ERI), the Pennsylvania Association of Plumbing, Heating and Cooling Contractors (PAPHCC), Albert M. Benincasa, QST Energy, Inc. (QST), and Southeastern Pennsylvania Transportation Authority (SEPTA). CNG ultimately withdrew as an individual participant but continued to participate through MAPSA. Comments were field by the Hon. Stewart Greenleaf, Senator, 12th District, Rufus L. Miley, and Nicholas J. DiMarino.

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[2] The Environmentalists consist of the Delaware Valley Citizens' Clean Air Council (Clear Air Council), the Sierra Club, Citizens Action, Pennsylvania Public Interest Research Group (PennPIRG), Grass Roots Alliance for a Solar Pennsylvania (GRASP), Nonprofit Energy Savings Investment Program (NESIP), and the Philadelphia Solar Energy Association (PSEA).

PECO and Sen. Fumo, CEPA (on behalf of itself, TAG, ACORN, and Mr. Long), Mr. Haver, the OTS, the OCA, the OSBA, PAIEUG, AARP, and the Navy (Joint Signatories) signed a Partial Settlement. On August 27, 1997, the Joint Signatories filed a Joint Petition for Partial Settlement of PECO's Proposed Restructuring Plan and Application for a Qualified Rate Order (Settlement Petition) in support of the Partial Settlement.

On October 7, 1997, EESPI[3] filed its Petition for Approval of an Electric Competition and Customer Choice Plan and for Authority Pursuant to Section 2807(e)(3) of the Public Utility Code to Serve as the Provider of Last Resort (PLR) in PECO's Service Territory at Docket No. P-00971265. By Order entered on October 9, 1997, EESPI's PLR Petition was consolidated with PECO's restructuring proceeding as captioned above.

On October 14, 1997, the Presiding Officers covered extensively this Commission's instructions relative to the establishment of a complete record, noting in particular that there would be one decision addressing the proposed Partial Settlement, the EESPI PLR Petition, and all unresolved issues.

On October 21, 1997, PECO, PAIEUG, Sen. Fumo, Mr. Haver, AARP, CEPA, TAG, ACORN, Mr. Long, the OCA, the OSBA, and the OTS filed Petitions for Reconsideration of the October 9 Order. On November 6, 1997, this Commission entered an Opinion and Order denying the relief requested in the October 21 Petitions for Reconsideration and offering, instead, an option to extend the date for Commission action until January 30, 1998. The November 6 Opinion and Order reiterated and clarified that the scope of the issues to be addressed included the Restructuring Plan, the proposed Partial Settlement, the EESPI PLR Petition, and all unresolved issues. The schedule was

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[3] On October 7, 1997, EESPI filed an application at Docket No. A-110059 for authority to provide service as a licensed electric supplier.

not extended, however, due to the filing of timely objections by Conectiv, NEV, and MAPSA.

The record in this proceeding contains a transcript of 2280 pages, as well as the statements and exhibits admitted into the record and the briefs of the parties. By Order entered on December 23, 1997, this Commission denied both the Partial Settlement and the EESPI PLR Petition. *In so doing*, the Commission rejected EESPI's contingency plan as well as the Partial Settlement. PECO was directed to make a compliance filing within twenty (20) days of the date of entry of the December 23, 1997 Order.

The instant six Petitions for Reconsideration were filed on January 7, 1998. PECO raises concerns regarding the stranded cost calculation, consumer education, and customer choice enrollment. The OCA raises concerns on the issues of stranded costs, customer rates, universal service, customer education, and consumer protections. PAIEUG asserts that the December 23, 1997 Order creates great uncertainty with respect to PECO's restructuring and requests reconsideration of the Order in view of the customer benefits that were contained in the Partial Settlement. EESPI addresses cost and stranded cost allocations, PECO's mitigation efforts, and unbundling. CEPA, *et al.*, seek reconsideration or clarification regarding the generation rate for residential customers who do not chose an alternative generation supplier, consumer protection, and funding for universal service and customer education. NEV expresses concern on the issue of the appropriate discount rate.

Answers to the Petitions were individually filed by PECO, EESPI and EPMI, the OCA, MAPSA, PAIEUG, NEV, Conectiv, DVSEUC, and SEPTA.

Discussion

At this stage in the proceeding, the six January 1998 Petitions for Reconsideration are seeking relief following our December 23, 1997 Order. The Code

establishes a party's right to seek relief following the entry of final decisions pursuant to Section 703 of the Code, 66 Pa. C.S. §703, relating to rehearings and rescission and amendment of orders. Subsection 703(g) provides that:

> (g) Rescission and amendment of orders.--The commission may, at any time, after notice and after opportunity to be heard as provided in this chapter, rescind or amend any order made by it. Any order rescinding or amending a prior order shall, when served upon the person, corporation, or municipal corporation affected, and after notice thereof is given to the other parties to the proceedings, have the same effect as is herein provided for original orders.

Further, such requests for relief must be consistent with Sections 5.572 of our Regulations, 52 Pa. Code §5.572, relating to petitions for relief following a final decision.

Additionally, consistent with Subsection 703(g) of the Code, *supra*, Section 5.572 of our Regulations, *supra*, and judicial and administrative precedent, the standards for a petition for relief following a final decision were set forth in *Duick v. PG&W*, 56 Pa. P.U.C. 553 (December 17, 1982) (*Duick*). *Duick* held that a petition for reconsideration under Subsection 703(g) may properly raise any matter designed to convince us that we should exercise our discretion to amend or rescind a prior Order, in whole or in part. Furthermore, such petitions are likely to succeed only when they raise "new and novel arguments" not previously heard or considerations which appear to have been overlooked or not addressed by us. (*Duick*, p. 559.) The Commonwealth Court case, *AT&T v. Pa. PUC*, 568 A.2d 1362 (Pa. Cmwlth. Ct. 1990), further elucidated the standards for rehearing, reconsideration, revision, or rescission.

In our opinion, the six Petitions for Reconsideration raise generally narrow issues that do not challenge the balance or direction of our December 23, 1997 Order. We believe that they properly raise matters designed to convince us that we should exercise our discretion to consider clarification or amendment, in part, of our

December 23, 1997 Order. Accordingly, we shall consider the instant Petitions on their merits.

A. Issues Related To Stranded Costs

1. Net Plant.

a. Reallocation of $98.9 million from transmission and distribution to generation. At page 80 of the December 23, 1997 Order, we generally adopted PECO's quantification of net generating plant in service. PECO is correct that the December 23, 1997 Order mistakenly neglected to include PECO's reallocation of $98.9 million of common and general plant from the transmission and distribution functions to the generation function during the rebuttal round of the proceeding. PECO made this correction to Exhibit ABC-1, Revised, in response to the recommendations of several other parties. We agree with PECO and the other parties that the subject $98.9 million is generation-related plant and should not be recoverable through transmission and distribution rates. This correction increases PECO's stranded costs by $98.9 million.

b. Plant No Longer Used and Useful. At page 81 of the December 23, 1997 Order, we adopted the recommendation of OCA witness La Capra to reduce net plant by $35.4 million to reflect plant no longer used and useful that should be retired and not carried on the company's books. The conclusion that plant no longer used and useful cannot be considered for recovery as a stranded cost is correct. PECO, however, properly points out that the adjustment to reduce net plant by $35.4 million requires an offsetting adjustment to reduce an equivalent value of accrued depreciation. These two adjustments balance each other out, so no adjustment to net plant is necessary. This correction increases PECO's stranded costs by $35.4 million.

These two net plant adjustments result in a total increase of $134.3 million in the book value of PECO's stranded assets and an equal increase in PECO's recoverable stranded costs.

2. Deferred Fuel Expense.

a. Fuel Expense Through Energy Cost Adjustment (ECA) Roll-In on December 31, 1996. At page 71 of the December 23, 1997 Order, we granted recovery of a regulatory asset for deferred fuel expenses and nuclear performance incentives actually recognized on PECO's books as of December 31, 1996, the date at which the ECA was rolled into base rates. The May 22, 1997 Qualified Rate Order (QRO) granted recovery of this expense. Since the QRO is irrevocable, the same recovery was authorized in the December 23, 1997 Order. The December 23, 1997 Order characterized this item as recovery of $96.162 million for the underlying expense and interest to the net present value date of December 31, 1998.

PECO properly points out that the QRO, in fact, categorized the total recoverable amount as $96.162 based on a quantification of interest only through June 30, 1997, not the relevant net present value date in this proceeding of December 31, 1998. PECO is correct that the recoverable amount would be $109.33 million if interest were calculated to the net present value date of December 31, 1998, and that OCA witness La Capra accepted this quantification. We shall accept this correction which increases PECO's stranded costs by $13.2 million.

b. Fuel Expense Post December 31, 1996. In the December 23, 1997 Order, we denied PECO's recovery of unrecovered fuel expense beyond December 31, 1996, based on the recommendations of OCA witness La Capra and PAIEUG witness Kollen. Those witnesses argued, and we agreed, that the reconciliation provisions of an ECA permit recovery only based on actual experience and documentation of the costs. Future energy costs are inherently not "known and measurable" at this point in time, could

not now be granted pursuant to an ECA, and, therefore, cannot qualify as recoverable stranded costs under the Act. The December 23, 1997 Order denied PECO's request for stranded cost recovery of $22 million for each of 1997 and 1998 and for $22.7 million for each year through the conclusion of the proposed transition period, December 31, 2005.

In its Petition for Reconsideration, PECO revises its prior claim instead to request recovery of $29.4 million for unrecovered fuel expense through November 30, 1997, and to allow recovery for additional fuel expense through December 31, 1998, as part of the CTC reconciliation proceedings. PECO has not asked for reconsideration of the denial of recovery for fuel costs beyond December 31, 1998.

At the outset, as several parties pointed out in their Answers to PECO's Petition, a petition for reconsideration of a final order is not an appropriate vehicle for presenting a new proposal or new evidence not in the record of the proceeding.[4] The decision in this case, whether within the December 23, 1997 Order or upon this reconsideration, can be based solely on the proposals and the record of this proceeding. For this reason, PECO's request for $29.4 million for unrecovered fuel expense through November 30, 1997, and its proposal to include additional fuel expense through December 30, 1998, in the CTC reconciliation must be denied. In addition, PECO's presentation of additional "evidence" concerning partial-year 1997 fuel costs through the Affidavit of Alan Cohn is a post-record submittal and cannot be considered in this proceeding.

By way of further clarification, we also will address the underlying issue. PECO requested, and we approved, the elimination of PECO's ECA pursuant to an Order adopted on May 22, 1997 at Docket Nos. P-00961126 and R-00963838 (the Roll-in Order). In the Roll-in Order, we explicitly defined calendar year 1996 fuel costs not fully

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[4] We note that PECO's proposal is not new and novel under the *Duick* standard, *supra,* in that PECO could have made this proposal on the record in this proceeding.

recovered due to the elimination of the ECA as a regulatory asset typically recoverable under current regulatory practice and, therefore, recoverable as stranded costs in this proceeding. In this proceeding, we have determined the recoverable amount to be $109.33 million, as discussed in this Opinion and Order, *supra*.

In contrast, we explicitly declined to identify post-1996 fuel expenses as recoverable stranded regulatory assets. Instead, we granted PECO the right "to defer and to seek to recover" such costs in this proceeding. In the Roll-in Order, we granted PAIEUG's request for an amendment of this Commission's Tentative Order, issued on December 19, 1996, to clarify that "the actual figure (for recovery of post-1996 fuel expenses), if it is to be allowed at all, will be set in PECO's restructuring proceeding." The Roll-in Order specified that, consistent with our long-standing practice, granting PECO the right to defer the expense for accounting purposes has no direct ratemaking implication. PECO's characterization in its Petition that the Roll-in Order "confirmed" the recoverability of 1997 and 1998 fuel costs is insupportable. Upon approval of the elimination of the ECA and the roll-in of variable energy costs into base rates as of December 30, 1996, PECO relinquished the right to have its fuel costs reconciled automatically because the annual fuel cost expense was subsumed into rates.

The Roll-in Order explicitly found that the rolled-in rates would be considered the rates subject to the rate cap that went into effect on January 1, 1997. PECO's rates were capped at January 1, 1997 levels for 54 months from January 1, 1997, but for exception(s) to the rate cap under the Act. Section 2804(4)(III)(D) of the Act provides that a significant increase in unit fuel cost such that the utility would not be able to earn a fair rate of return could be an exception to the rate cap.

PECO does not assert that its fuel expenses constitute a valid exception to the rate cap, however. In its Answer to PECO's Petition, the OCA recalled OCA witness Catlin's testimony that recovery of 1997 and 1998 fuel costs would be inappropriate while

PECO remained under traditional regulation without a demonstration that its existing rates are inadequate. (OCA Stmt. No. 3 at 17.) PECO merely asserts that it is entitled to recover an alleged underrecovery of its fuel costs despite the fact that PECO eliminated its fuel cost adjustment clause in 1996. PECO cannot, by definition, both subsume its fuel expense into base rates and request an annual reconciliation of fuel costs. Granting stranded cost recovery for fuel costs after the December 30, 1996 effective date of the roll-in and the rate cap would circumvent the rate cap and render the end of the reconciliation provisions meaningless. For these reasons, the relief sought through PECO's request for reconsideration of this issue is denied.

3. Deferred Limerick Common Plant.

On page 76 of the December 23, 1997 Order, we authorized recovery of the same $175.8 million for deferred Limerick Common Plant expense as was authorized pursuant to the May 22, 1997 QRO. PECO correctly identifies a Commission error in identifying this amount as $158.3 million in the stranded cost recovery tabulation total on page 101 of the Order. Correction of this error increases stranded costs by $17.5 million.

4. SFAS 106 Deferred Costs.

PECO claimed recovery of $32.615 million for the unamortized balance of 1993 and 1994 deferrals that had previously been included in rates pursuant to a 1994 settlement agreement. We granted full recovery of this amount on a net present value basis of $20.394 million as of December 31, 1998. No party seeks reconsideration of this issue.

We denied PECO's additional claim for $67.965 million for stranded costs related to its 1994 early retirement programs (VSIP/VRIP expenses). PAIEUG witness Kollen testified these expenses would not have been recoverable under traditional ratemaking. We adopted generally the analysis of witness Kollen that stranded cost

recovery, at this time, of the one-time, non-recurring 1994 expenses would constitute inappropriate, single-item, retroactive ratemaking.

In its Petition, PECO asks us to reconsider our conclusion that the VSIP/VRIP expenses were never previously included in rates. PECO asserts that the VSIP/VRIP expenses were, in fact, included in rates pursuant to a 1994 settlement at Docket No. R-00922479. In direct testimony, PECO stated that "the [1994] settlement provided that PECO would be permitted to increase its electric base rates by $25 million to fully fund its SFAS 106 obligation." (PECO Stmt. No. 3 at 32-34.) Additionally, PECO indicated that the settlement provided that the SFAS 106 costs deferred by PECO for the years 1993 and 1994 pursuant to the Commission Order approving the 1994 settlement would be amortized over an 18-year transition period and that such amortization "will be subsumed in the rates prescribed" by the settlement. PECO explicitly indicated that "a revenue stream to fund [the transition] expense has been provided as part of the $25 million base rate increase implemented pursuant to the settlement. . . ." (PECO Stmt. No. 3, p 33.)

We again have reviewed the record in this proceeding, the 1994 settlement, and related Commission Orders, and we conclude that the December 23, 1997 Order permits PECO full recovery of all appropriate SFAS 106 costs. PECO has provided no support in the record of this proceeding that the VSIP/VRIP expenses require any additional recovery. We reaffirm our conclusion that the VSIP/VRIP expenses reflect one-time transition costs during 1994 for which present recovery would constitute inappropriate single-issue and retroactive ratemaking. In any event, the settlement fully incorporated all 1993 and 1994 transition costs, and no additional recovery is appropriate.

For the foregoing reasons, PECO's request for relief on this issue is denied.

5. SFAS 106 Trust Fund Earnings.

In its Petition for Reconsideration, PECO claims that it is entitled to retain all trust fund earnings as part of the basic actuarial funding stream for the trust fund expenses.

In the December 23, 1997 Order, we adopted PAIEUG witness Kollen's recommendation to recognize a regulatory liability of $151 million for SFAS-106 trust fund earnings. We reaffirm our conclusion that PAIEUG witness Kollen's testimony fully supports this adjustment. (PAIEUG Stmts. Nos. 3, p. 33, and 3S, p. 18.)

The December 23, 1997 Order should, however, be clarified on this issue. The December 23, 1997 Order does not eliminate trust fund earnings in support of the underlying expense, as PECO asserts. Rather, the December 23, 1997 Order establishing a regulatory liability for trust fund earnings recognizes the importance of those earnings. PECO's argument does not appear to accept two basic requirements for a determination of recoverable net stranded costs in this proceeding, however. First, this proceeding establishes a demarcation date of December 31, 1998, after which only PECO will be responsible for generation-related expenses. Second, the determination of recoverable stranded costs must reflect the net present value of those costs as of December 31, 1998. Our finding that PECO has a regulatory liability related to trust fund earnings properly incorporates these requirements of the Act. Consumers should receive credit for the present value of that portion of trust fund earnings associated with consumer funding responsibility through December 31, 1998. PECO's argument that it should be permitted to retain trust fund earnings in order to account for future inflation and cost escalation is inconsistent with a determination of the net present value of its stranded costs and the fact that it is responsible for the share of funding after January 1, 1999. The only evidence of record relative to the amount of this adjustment is PAIEUG's figure of $151 million. PECO argued against any adjustment and suggested no alternative calculation for the adjustment.

Thus, the regulatory liability of $151 million is affirmed and should be considered as an offset to recoverable regulatory assets.

6. Pension Fund Overcollection.

The December 23, 1997 Order adopted the recommendations of PAIEUG witness Kollen and Navy witness Smith to establish a regulatory liability to reflect $217.347 million of overfunded pension plans. PECO does not dispute that the overfunding exists but argues that the overfunding can quickly dissipate based on reduced performance of the stock market. Additionally, PECO argues that it has no ability to withdraw the overfunded sums to compensate for the regulatory liability adopted by us.

In its Petition, PECO indicates that it has included only $200,000 of annual pension expense as an operating expense in its market valuation instead of $13.4 million that would be required as annual pension contributions in the absence of the current overfunding. PECO argues that this reduced future expense is "credited" to consumers as decreased future operating expenses, increasing the value of its generation assets and limiting the amount of stranded costs.

While we continue to agree that overfunding of pension expense can be credited to consumers as a regulatory liability, we are persuaded to reconsider our decision. PECO's approach is reasonable under the circumstances because PECO has provided an alternative methodology to credit consumers with the economic benefit of the overfunding through the increased valuation of its stranded assets. We decline to retain the regulatory liability and adopt a new adjustment to increase the pension funding expense to $13.4 million, thereby requiring a recalculation of the market value of PECO's generating assets at this stage of the proceedings.

Thus, we shall grant PECO's request for relief on this issue, resulting in an increase in stranded costs of $217.347 million.

7. SFAS 109 Deferred Taxes.

In the December 23, 1997 Order, we granted PECO's claim for $1.687 billion as a recoverable regulatory asset for deferred taxes. PECO calculated the amount as a nominal value but did not request any return on the recoverable amount. PECO did not present all of its stranded cost claims on a net present value basis in its Restructuring Plan but argues in its Petition that it reached a comparable result by not requesting a return on certain claims.

In their Petitions, PECO, the OCA, and PAIEUG point out that we concluded that the Act requires all stranded cost claims to be stated on a net present value basis and adopted an approach that grants the same return for all recoverable stranded assets. PECO, the OCA, and PAIEUG properly conclude that the December 23, 1997 Order, therefore, overstates PECO's stranded cost by awarding the nominal value of the claim as well as a return on it. We note that the specific analytic framework suggested by the OCA for properly quantifying the SFAS 109 claim comports with PECO's presentation of the issue. In its Answer to the Petitions, PAIEUG indicates its support of PECO's and the OCA's request and agrees with PECO that the adjustment should be $471 million.

We shall grant relief on this issue and adopt this adjustment.

8. Reallocation of Administrative and General Costs to Generation.

The OCA, Enron, and NEV request reconsideration of the December 23, 1997 Order concerning the impact on stranded costs of reallocations from the transmission and distribution function to the generation function. On page 62 of the December 23, 1997 Order, we concluded, subject to the accepted compliance filing, that the reallocation would result in an increase in PECO's stranded costs of approximately $460,691,000, although the precise number would be established upon acceptance of PECO's compliance filing.

If administration and general (A&G) expenses are reallocated to generation, they must be considered in the same way that any operating expenses are considered to assess the market value of the generating asset. Increased operating expenses reduce market value and, therefore, increase stranded costs. The requested modification on this issue is, therefore, denied.

B. Issues Other Than Stranded Costs.

1. Universal Service Cost Recovery.

The OCA and CEPA seek reconsideration of the decision retaining universal service cost responsibility as it is in existing rates. We agree with PAIEUG in its Answer that the Petitions raise no new arguments not already fully raised and duly considered on this issue and that relief requested is, therefore, inappropriate.

2. Market Power Investigation.

CEPA argues that we have not conducted a market power analysis pursuant to Section 2811(a) and (b) of the Act to consider whether the market will, in fact, be competitive. This request misunderstands Section 2811 and is, therefore, denied. Section 2811 establishes no preconditions to approval of a restructuring plan. Any party or the Commission may initiate a market power investigation pursuant to Section 2811 if there is good cause to believe that a market power problem exists. Moreover, we agree with PECO's Answer that CEPA should have presented evidence on this issue during the proceeding if CEPA was concerned about PECO's market power inhibiting the development of a competitive market. We reaffirm our conclusion that the Restructuring Plan adopted by the Commission will create a vibrant, competitive market.

3. Termination Upon Nonpayment of Supplier Bill.

The OCA and CEPA request clarification that PECO may not disconnect a customer from the grid for failure to pay a supplier bill. We do not believe that any clarification is necessary on this issue because PECO has acknowledged in its Answer that the Commission has clearly adopted the rule in other proceedings that a customer can only be disconnected from the grid for nonpayment of an EDC charge or provider of last resort charge for generation services.

4. Switching Fees.

The OCA is correct that the December 23, 1997 Order mistakenly omitted specific discussion of switching fees. Reconsideration is granted of this omitted issue. We shall adopt the recommendation of OCA witness Alexander that a switching fee is inappropriate during the early stages of customer choice and direct PECO to consider the guidelines proposed in OCA Statement. No. 5S at 10-11 in proposing any switching fee in the future.

5. Consumer Education.

PECO seeks reconsideration and clarification regarding its consumer education proposal. Specifically, PECO urges reconsideration of the December 23, 1997 Order to the extent that we discussed its budget as a three (3) year budget of $24 million. PECO also urges reconsideration or clarification relating to our discussion and direction that 65% of its proposed budget be allocated to a statewide consumer education program.

In its Petition, PECO argues that its proposal contained a four (4) year budget which provided for $24 million. That proposal included $5.6 million allocated for consumer education activities for 1997. According to PECO's Petition, PECO has

devoted approximately $1 million of its 1997 budget to statewide programs. Accordingly, $18.6 million of its proposed budget remains for the years 1998-2000.

Based on the foregoing, PECO seeks approval of its proposed consumer education program on the basis of a four-year, $24 million dollar budget or, in the alternative, a budget of $18.6 for the period of 1998-2000. PECO also seeks clarification that the precise allocation of its budget to the statewide program be reserved to a separate proceeding establishing a statewide consumer education program.[5]

The OCA seeks reconsideration of our discussion of PECO's consumer education proposal to the extent that the OCA requests the inclusion of consumer representatives from regions in addition to PECO's service territory. CEPA seeks reconsideration of our discussion of PECO's consumer education proposal and states a concern that PECO's ratepayers may be called upon to fund consumer education costs for customers outside of PECO's service territory. CEPA agrees that PECO customers may be required to pay their proportional share for a statewide program but that a determination of the scope of the statewide program is outside of the scope of this proceeding.

We will grant, subject to review of PECO's compliance filing, PECO's request for relief relating to the budget for its consumer education program. As PECO has stated, its proposed budget of $24 million was stated on a four-year basis. We note, however, that PECO's Petition for Reconsideration states that $5.6 million had been allocated for consumer education in 1997 without indicating the amount actually spent. It, therefore, is not clear whether its remaining budget is actually $18.6 million for the period 1998-2000, or some greater figure. In addition, the amount spent must have been expended on consumer education as contrasted with marketing or public relations

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[5] *Creation and Implementation of a Statewide Consumer Education Program for Electric Restructuring in the Commonwealth of Pennsylvania,* Docket No. M-00981036, adopted on January 15, 1998 (*Consumer Education*).

activities related to this proceeding. Accordingly, PECO must provide an accounting of its 1997 consumer education expense in the compliance filing sufficient to enable us to determine its consumer education funding for the period 1998-2000.

In addition to recognizing our misstatement of the budget time frame, we recognize that both PECO and CEPA have raised a legitimate question relating to setting the allocation between the statewide effort and local efforts in this proceeding. Although we believe that a 65%-35% allocation of funds to statewide effort and local effort, respectively, is an appropriate and justified ratio, we agree that the precise allocation can and will be addressed in our statewide proceeding.

Finally, we note that in our discussion of the committee to oversee the content of the statewide consumer education program, we provided for representation on that committee for the Executive Director of the Energy Coordinating Agency of Philadelphia. The OCA has suggested that there should be direct representation of consumers from areas in addition to Philadelphia. As discussed in *Consumer Education, supra*, the list of representatives for the committee was not intended to be exclusive. We will entertain comments in that proceeding addressing appropriate members to serve on the committee. We will also retain authority to expand committee membership as circumstances warrant.

6. <u>March 1, 1998 Open Enrollment Date</u>.

On page 47 of the December 23, 1997 Order, we directed PECO to initiate an open enrollment period beginning March 1, 1998 for the 66% of PECO consumer load eligible to shop on January 2, 1999. In its Petition, PECO requests that the March 1, 1998 start date be reconsidered and extended for several months. PECO asserts that beginning enrollment on March 1, 1998, would deny PECO customers the benefit of an orderly and coordinated education outreach program and precede final resolution of generic issues and rulemaking proceedings affecting the procedures and regulations that will be in effect.

We shall reconsider the March 1, 1998 enrollment commencement date and direct that PECO commence enrollment on April 27, 1998. All parties should note the "enrollment" is only the act of volunteering by informing PECO, directly or through a supplier, that the consumer wishes to participate in the phase-in. Customers need not select a supplier in order to obtain a slot in the program.

We shall grant this extension at PECO's request in order to give PECO more time to prepare for enrollment although we do not agree that an extension is necessary for effective consumer education or to permit all generic proceedings to be completed. The April 27 commencement date will provide sufficient advance opportunity for effective preparation and consumer education as well as sufficient time for consumers to shop for a supplier.

As discussed above, relative to *Consumer Education, supra*, a quality consumer education program will be conducted in PECO's service territory. Quality consumer education must occur over an extended, not limited, period of time and will be more effective if conducted while consumers may act on what they have learned.

The conclusion of all generic proceedings is not a pre-condition to the commencement of enrollment. The generic proceedings will not all be concluded by July 1, 1998, in any event. Specific protocols and regulations will continue to be adopted from time to time.

7. Generation Charges for Customers Not Shopping.

The December 23, 1997 Order, at pages 132-134, fully details the terms of service for customers who do not have a competitive supplier.

The OCA and CEPA raise questions in their petitions concerning the rates that PECO may charge for generation services to customers who do not shop. Neither

party has raised new arguments not already considered by us, and reconsideration, therefore, is denied. Some comments are appropriate, however, in order to correct some mischaracterizations and misunderstandings.

PECO, as an EDC, remains a regulated utility and may only offer Commission-approved, tariffed rates. In this proceeding, no party provided evidence that PECO's regulated rates should be reduced under traditional ratemaking. Protected by the statutory rate caps, customers who do not shop remain regulated rate customers of PECO on the same terms and conditions of services unless changed by Commission Order. As summarized on page 46 of the December 23, 1997 Order, the "shopping credit" is not relevant to a customer who does not shop. Customers who do not shop pay the approved tariffed rate divided into unbundled generation, transmission, and distribution charges.

8. Phase-In and Enrollment Issues.

In order to ensure that no further delays are necessary, and in response to the issues raised in the Petitions indicating concern that the enrollment process requires clarification, we will take this opportunity to emphasize and detail the enrollment process that we envision. The compliance filing should reflect these directions.

PECO shall distribute a notification letter and explanatory information to all customers over a period of not more than one week ending on April 13, 1998. The materials shall specify that enrollment in the phase-in is separate from supplier selection. Enrollment forms may be distributed both by PECO and suppliers but may not include a supplier selection. A customer may enroll in the phase-in directly through PECO or through a supplier, but the customer may not select a supplier at the same time.

Customers participating in the pilot program and others representing the first 33% of non-coincidental peak load to volunteer to enroll after the April 27 commencement date may receive competitive supply in the January 1, 1999 phase-in

group. When the 33% threshold is reached for any tariff class, PECO shall send a notification letter to all such customers that they will be in the first phase-in group.

If fewer than 66% of customers in any tariff class are enrolled as of July 1, 1998, PECO shall send a notification letter to all volunteers as of that date who are not in the January 1, 1999 phase-in group that they will be in the January 2, 1999 phase-in group. Enrollment will continue until completed, with additional notification letters sent not less frequently than every two weeks. In such situations, the enrollment will be completely "first-come, first-served," and no lottery will be necessary.

If more than 66% of customers in any tariff class have volunteered as of July 1, 1998, PECO shall have an independent party conduct a lottery to determine which of the customers representing the additional load beyond the January 1, 1999 phase-in group will be included in the January 2, 1999 phase-in group. PECO shall send a letter notifying participants of selection through the lottery not later than July 15, 1998.

In its Petition, PAIEUG requests that we reconsider our participant selection procedure to ensure that all volunteer industrial customers may participate in the first two phase-in groups. Instead of conducting a lottery in the event of overenrollment, PAIEUG recommended that all volunteering customers in each tariff class may participate with a pro rata partial load in order to avoid any competitive disadvantages. (PAIEUG Stmt No. 1, pp. 57-58.) We shall modify the December 23, 1997 Order to reflect PAIEUG's concern as applied to the industrial tariffs in order to avoid any competitive disadvantage.

Participants may notify PECO of a selected supplier any time after receipt of the letter from PECO informing them that they have been included in the phase-in group. The selection shall be made by written notice submitted directly to PECO or through a supplier. All customers shall receive a letter from both PECO and the supplier confirming the selection within 15 days of notice of the customer's choice. The

confirmation letter shall indicate the date that the new supplier service will become effective and when they will receive their first bill. Power will be provided by PECO until a customer selection is implemented. Any participant selecting a supplier by November 1, 1998, will receive energy through their chosen supplier in the first billing cycle following their phase-in date. Failure to choose a supplier by November 1, 1998, does not terminate participation in that phase-in group.

The compliance filing shall include proposed letters inviting enrollment and notification of acceptance in each phase-in group as well as other consumer education materials to be included in the initial mailing notifying customers of the enrollment period and procedures. The letters for residential and small commercial customers shall reflect the considerations in the December 23, 1997 Order, this Opinion and Order, and the other dockets addressing this issue. In particular, the notices shall: (1) Identify and explain the unbundled bill components, including the amount and significance of that customer's shopping credit; (2) List the name, address, phone number and e-mail address of each licensed supplier in fact serving the class of customers; (3) Provide PECO and PUC customer information telephone numbers; (4) Explain the advantage of selecting a supplier by November 1, 1998, as described above; and (5) Explain that failure to choose by November 1, 1998, does not terminate the customer's right to participate in that phase-in group, as described above.

We shall provide comments on the draft letters to PECO as soon as possible after the review of the comments from other parties which are due on or before January 27, 1998. In order to avoid delays, Commission approval will be granted informally, prior to acceptance of the compliance filing itself.

9. Compliance Filing Issues.

PECO did not submit a compliance filing as required by the December 23, 1997 Order and did not submit a request for an extension of the due date until Friday,

January 9, 1998. By Secretarial Letter dated January 13, 1998, we informed PECO and the other parties that the overdue compliance filing was then due on January 20, 1998. While we recognize that some revisions to the compliance filing are now required because of the clarifications, corrections, and relief granted in this Opinion and Order, the relatively modest revisions to the compliance filing can and must be completed by the extended deadline of January 20, 1998.

Other parties will have until January 27, 1998 to submit comments on the compliance filing. We expect to issue a compliance filing Order at Public Meeting of February 5, 1998. We remain committed to expeditious and effective implementation of the approved restructuring plan, and we expect the fullest cooperation from all parties. The compliance filing accepted by this Commission will precisely reflect the intent of the December 23, 1997 Order. Successful implementation of the approved restructuring plan requires well written tariffs and company rules and procedures.

The Petitions and Answers indicate concerns about the proper calculation of the stranded cost that result upon the reallocation of A&G expenses from transmission and distribution functions to the generation function. In the December 23, 1997 Order, we estimated the impact as $460,691,000, subject to the compliance filing. PECO should calculate the increased stranded investment produced by the allocation of A&G expense to generation assuming that the annual $38,701,357 A&G expense escalates at the annual gross domestic product (GDP) deflator found in PECO's Statement No. 1. (PECO Exh. TPH-5, p. 6.) PECO should use the discount rate of 7.6% adopted by us at page 89 of the December 23, 1997 Order. Lastly, PECO should exclude the tax gross up by multiplying the resulting present value by .587 to reflect PECO's tax rate of 41.3%. In addition, as noted in the December 23, 1997 Order, PECO is to remove all revenue requirements gross-ups from the A&G reallocation in its compliance filing.

The compliance filing shall calculate the CTC in the manner described in the Order and restated for clarification as follows: (1) The CTC is to be calculated recognizing the monthly receipt of revenue by PECO; (2) The CTC is to be calculated using a 7.47 percent rate of return, inclusive of all revenue requirements; (3) The CTC is to be allocated to each customer class in a manner that does not shift inter-class and intra-class costs and maintains consistency with utility production plant accepted by us in PECO's most recent base rate proceeding. In order to avoid confusion, we note that PECO has provided data suggesting that the Rate R CTC will be no more than 12.57% above the system-wide CTC for each and every year of the transition period; (4) The CTC is to be calculated using a system-wide consumption of 33,569,358 MWh for 1999; and (5) The CTC is to trued-up annually consistent with Section 2808 (f) of the Act.

Conclusion

For the reasons discussed herein, the Petitions for Reconsideration are granted, and the relief requested is granted, in part, and denied, in part, consistent with this Opinion and Order. Any issue raised in a Petition but which is not expressly addressed or modified pursuant to this Opinion and Order has been duly considered and is hereby explicitly denied. The December 23, 1997 Order shall be modified, clarified, and corrected in accordance with this Opinion and Order. In all other respects, the December 23, 1997 Order shall be affirmed. In summary, the Table at page 101 of the December 23, 1997 Order is revised and restated in the Appendix of this Opinion and Order to reflect the adjustments made pursuant to this Opinion and Order that affect PECO's total recoverable stranded costs. To the extent that numbers have been rounded for the ease of discussion herein and in the Appendix, the compliance filing shall reflect the exact and precise calculations.

Further, PECO shall no longer be required to submit a compliance filing based solely on the December 23, 1997 Order but instead shall submit a compliance filing

based on the December 23, 1997 Order as modified by this Opinion and Order. The compliance filing shall be due on or before January 20, 1998, and shall precisely reflect the balanced considerations reflected in the December 23, 1997 Order as reconsidered, clarified, amended, and corrected by this Opinion and Order. Interested parties may file comments to the compliance filing on or before January 27, 1998.

With the corrections, clarifications, and modifications granted herein, this Commission, PECO, and the other parties to this proceeding, as well as the electric consumers in this Commonwealth, will be well-positioned to begin and implement successfully the difficult task of moving expeditiously and effectively to a full competitive electric generation market; **THEREFORE,**

IT IS ORDERED:

1. That the Petitions for Reconsideration, filed in this proceeding by PECO Energy Company; Enron Energy Services Power, Inc., and Enron Power Marketing, Inc.; the Office of Consumer Advocate; the Consumer Education and Protective Association, the Tenant Action Group, the Association of Community Organizations for Reform Now, and John W. Long; the Philadelphia Area Industrial Energy Users Group; and New Energy Ventures, relative to this Commission's December 23, 1997 Opinion and Order addressing PECO's proposed Restructuring Plan, are granted and the relief requested is granted, in part, and denied, in part, consistent with this Opinion and Order.

2. That this Commission's December 23, 1997 Opinion and Order addressing PECO Energy Company's proposed Restructuring Plan is modified, in part, consistent with this Opinion and Order, and affirmed in all other respects.

3. That PECO Energy Company's compliance filing, together with all necessary data and analyses, is due on or before January 20, 1998, and must actually be

received at the Commission's Office of the Secretary by the close of business on that date.

4. That comments relative to PECO Energy Company's compliance filing are due on or before January 27, 1998, and must actually be received at the Commission's Office of the Secretary by the close of business on that date.

5. That the compliance filing and comments thereto are to be filed with the Commission's Office of the Secretary, with copies to each Commissioner's Office and to the Commission's Bureau of Fixed Utility Services and the Office of Special Assistants. Such filings are to be by hard copy with electronic versions attached consistent with prior directives relative to electronic versions.

6. That PECO Energy Company's compliance filing, together with all necessary data and analyses, shall be served on all active parties of record to this proceeding.

BY THE COMMISSION,

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: January 15, 1998

ORDER ENTERED: January 16, 1998

Appendix

Replacing page 101 of the Restructuring Order:

Recoverable Regulatory Assets	$ millions Restructuring Order 12/23/97	$ millions Restructuring Reconsideration Order	$ millions Net Change
SFAS 106	20.394	20.394	0
Deferred Fuel Expense	96.162	109.3	13.168
SFAS-109 Deferred Taxes	1,687.1	1,216.3	(470.8)
Compensated Absences	16.587	16.587	0
Miscellaneous Nuclear expenses	0	0	0
Limerick Early Window	65.446	65.446	0
Deferred Limerick Common Plant	158.3	175.8	17.5
Deferred Common Plant for Peach Bottom, Eddystone, & Salem	17.4	17.4	0
Unamortized Loss Reacquired Debt	158.311	158.311	0
SUBTOTAL	$2.2197 billion	$1.7796 billion	($440.132 million)
Offsetting Regulatory Liabilities			
Pension Fund Overcollection	(217.347)	0	217.347
SFAS 106 Trust Earnings	(150.861)	(150.861)	0
SUBTOTAL	($368.208 million)	($150.861 million)	($217.347 million)
Non-utility Generating Contracts	0	0	0
Nuclear Decommissioning Expense	0	0	0
TOTAL SECTION 2808(c)(1) and (2) STRANDED COSTS	$1.8515 billion	$1.6267 billion	($222.785 million)
Utility Generation	$billions	$billions	$billions
Book Value	6.639	6.773	134.3
less market value	3.96	3.96	0
Total Stranded Generation Cost	2.679	2.813	134.3
Fossil Decommissioning Expense	0	0	0
Other Transition Costs	.033	.033	0
Reallocation of A&G Expense to Generation	.461	.461	0
TOTAL RECOVERABLE STRANDED ASSETS	$5.024 billion	$4.935 billion	($88.5 million)

REVISED

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

PENNSYLVANIA PUBLIC UTILITY COMMISSION v.	PUBLIC MEETING- JANUARY 15, 1998 JAN-98-C-1 R-00973953
PECO ENERGY COMPANY PECO Application for Approval of Its Restructuring Plan and Joint Petition for Partial Settlement	
and	
Petition of Enron Energy Services Power, Inc., for Approval of an Electric Competition Choice Plan and for Authority Pursuant to Section 2807(e)(c) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company	P-00981265
Petitions for Reconsideration or Clarification of Order Approving Modified Restructuring Plan for PECO Energy Company	

CONCURRING AND DISSENTING JOINT STATEMENT OF
CHAIRMAN JOHN M. QUAIN AND VICE CHAIRMAN ROBERT K. BLOOM

This matter comes before us on several Petitions for Reconsideration of the Commission's Order entered December 23, 1997. Today, the Commission has ruled on those Petitions, correcting, clarifying, and modifying its order in some respects. Our dissent from the December 23, 1997, Order is a matter of record. We find that we must respectfully concur and dissent with respect to the resolution of the Petitions for Reconsideration as embodied in the Motion of Commissioner Hanger offered today.

We concur with those parts of the Motion that correct certain findings contained in the December 23, 1997, Order. We believe, however, that the Motion is deficient in a number of respects, and therefore we must also dissent.

First, in the proposed treatment of SFAS 106 expenses, the denial of the claimed portion of $67 million of early retirement expenses is inconsistent with the recognition of the action as a mitigation effort. That denial is also inconsistent with the reduced ongoing allowance for the expense as part of the market valuation for generation property.

Further, the use of earnings on the SFAS 106 trust as an offset for non-SFAS 106 related expenses appears improper from both an accounting and a policy standpoint. Finally, the treatment of SFAS 106 expenses represents a mismatch of present value calculations rather than a matter of overfunding.

We must also disagree with the majority regarding the timing of open enrollment for PECO customers. While the motion grants a delay until April 27, 1998, for enrollment to begin, we believe that this early enrollment period will not afford customers the benefits of Commission-led education programs. We note, however, that these same customers will be funding those programs through their CTC charges. Our preferred position would be to have the initial enrollment period coincide with the expected enrollment periods for the other electric distribution companies in the region. Hence, we prefer a July 1, 1998, open enrollment date.

Finally, the majority does not provide PECO with an adequate time frame for compliance, nor the parties with an adequate period for response to the compliance filing. We would allow a ten day time period from the entry date of the final order on reconsideration for PECO to make its compliance filing. Moreover, we would provide the parties with two weeks thereafter to review the submission and to file comments. The early enrollment date supported by the majority is evidently driving the entire time frame for review, yet this is a review which must be made very carefully. The rates and charges which need to be considered will be in effect for a number of years, and continuing revision of the numbers which may result from unnecessary haste at this point could hinder the ability of other market participants to develop their services and products.

For the foregoing reasons, we concur and dissent on this Motion.

1-15-98
DATE

JOHN M. QUAIN
CHAIRMAN

1-15-98
DATE

ROBERT K. BLOOM
VICE CHAIRMAN

CERTIFICATE OF SERVICE

I hereby certify that I am this day serving two true copies of the foregoing document upon the participants listed below in accordance with the requirements of Section 1.54 (relating to service by a participant).

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Pamela C. Polacek

Pamela C. Polacek, Esq.

Dated this 10th day of February, 1998, in Harrisburg, Pennsylvania.

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February 12, 1998

DOCUMENT
FOLDER

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
North Office Building-Filing Room
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: *Duquesne Light Company Application for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code, Docket No. R-00974104.*

Dear Mr. McNulty:

Enclosed, please find 8 copies of revised pages 11 & 12 and a "Stranded Cost Summary" to replace those previously submitted as part of the Main Brief of David Hughes in the above-referenced matter. A true copy of these revisions has been served upon all parties of record.

Thank you for your attention to this matter.

Yours truly,

David Hughes
4037 Ludwick St.
Pittsburgh, PA 15217
(412) 421-4163

DOCKETED
FEB 26 1998

Enclosures

cc: Judge john H. Corbett, Jr.
All parties

CONCLUSION

To conclude: first, as per section 1312 of the Public Utility Code, rate payers are due a refund for the losses associated with the Perry 1 and BV2 nuclear units since 1990. Second, there is no justification for recovery of future costs associated with the Perry 1, BV 2, Brunot Island and the Phillips investments. Duquesne has failed to adequately mitigate its stranded costs as required by the Act and has not met its burden of proof in rebutting the arguments for disallowance. For the Company to request 100% stranded cost recovery, assumes that the current rates would remain in effect for the life of the units in question. I submit that, had deregulation not occurred, it is extremely unlikely that Duquesne's current rates would have remained in place for long. The Commission would eventually do what I am asking it to do now: First, adjust Duquesne's current rates to a level that is just and reasonable, and make the adjustment retroactive, as per section 1312 of the Public Utility Code, to 1990. Second, disallow the cost of Perry 1, BV2, Brunot and Phillips stations from any stranded cost recovery.

Accordingly, I request that the Commission consider implementing one of the following three remedies (All figures in 1999 present value dollars):

1. Using Mr. Biewald's unrebutted calculations, and keeping in mind section 1312 of the code, issue a refund to rate payers of $2,245 million for Perry 1 and BV2 losses experienced from 1990 to 1998. Disallow the full value of Perry and BV2 from stranded cost recovery, or $934.4 million, or

2. Refund $2,245 million and based on Mr. Biewald's Exhibit BEB 5 & 6, disallow $527 million in stranded cost recovery for Perry 1 and BV2 losses for the years 1999 through 2026, or

3. In the spirit of compromise and sharing of the burden as required by the Act, the Commission should, at the very minimum, issue a refund to customers in the amount of $1,123 million and order a stranded cost recovery disallowance of one half the Company's claim of $1,899 billion, or $949.5 million.

These recommendations only deal with the costs addressed in this brief and are not to be considered as my proposal for total stranded cost disallowance/recovery. For example, I have not offered testimony or calculated appropriate recovery amounts for Regulatory Assets. However, as I have repeatedly argued, any stranded cost award in excess of 50% of the amount the Commission determines to be recoverable, would be in violation of the Act. Thus, if the Commission were to accept Duquesne's stranded cost claim of $1,899 billion, the Company should be permitted to recover no more than $949.4 million.

Finally, I request that the Commission discount any stranded cost recovery in the amount that Duquesne received as part of its settlement with the General Electric Company relative to the GE Mark III reactor problems at the Perry Plant.

Respectfully submitted,

David Hughes

February 10, 1998

DAVID HUGHES MAIN BRIEF

SUMMARY OF STRANDED COSTS

($000)

OPTION 1

	Company Claim	Adjustments	Adjusted Amount
Nuclear	934,400	934,400	-0-
Fossil	607,290	268,500(HHS)	338,780
Regulatory Assets	357,280		
Total Net Present Value (NPV) in 1999$	1,898,970		
PUC Jurisdictional *Percent*	99.9%		

OPTION 2

	Company Claim	Adjustments	Adjusted Amount
Nuclear	934,400	527,000(Biewald)	407,400
Fossil	607,290	268,500(HHS)	338.790
Regulatory Assets	357,280		
Total Net Present Value (NPV) in 1999 $	1,898,970		
PUC Jurisdictional Percent	99.9%		

OPTION 3

	Company Claim	Adjustments	Adjusted Amount
Nuclear	934,400	467,200(50%)	467,200
Fossil	607,290	268,500(HHS)	407,400
Regulatory Assets	357,280		
Total Net Present Value (NPV) in 1999 $	1,898,970		
PUC Jurisdictional Percent	99.9%		

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code	} } }	Docket No. R-00974104

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of revised pages 11 & 12 and the "Stranded Cost Summary" of the Main Brief of David Hughes upon the presiding officer and all parties of record in the above-referenced proceeding, in accordance with the requirements of 52 Pa. Code, Section 1.54 (relating to service by a participant) in the manner and upon the persons listed below.

Dated this 13th day of February, 1997

David Hughes
4037 Ludwick St.
Pittsburgh, PA 15217
(412) 421-4163

VIA FIRST CLASS MAIL

ORIGINAL

RECEIVED

FEB 10 1998

PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

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February 12, 1998

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Application of Duquesne Light Company for Approval of its Restructuring Plan, Docket No. R-00974104

Dear Mr. McNulty:

Thank you for letting me know that we filed the incorrect number of copies of our brief on Tuesday in the above-captioned proceeding.

Enclosed are an original and seven copies of the Environmentalists' brief in the Duquesne Light restructuring proceeding to supplement the two copies we filed on February 10th.

I discovered that the two copies of our Duquesne brief we delivered to your office were printed without the final eleven pages. I am enclosing two sets of these missing pages to be added to the earlier-filed copies. The copies I enclose with this letter are complete.

To make certain that no one else was missing these pages, I have also faxed and mailed these additional pages to Judge Corbett and the parties on the service list.

Sincerely,

DOCUMENT FOLDER

Roger E. Clark

Roger E. Clark
Attorney for the Environmentalists

Enclosures: Original and seven copies of the Duquesne Light brief of the Environmentalists
Two sets of the missing final pages

D. Consumer Information

In adopting the Competition Act, Pennsylvania lawmakers were keenly aware that customers need ample and accurate information in order to exercise informed choice about their electric supply options. Thus, under terms of the Act, the Commission is required to facilitate informed customer choice, by issuing regulations ensuring that the information supplied to consumers in an understandable format that enables consumers to compare prices and services on a uniform basis.[88] The Environmentalists contend that one of the important pieces of information needed and desired by many customers is the environmental byproducts of their electricity.

On July 10, 1997, and during the pendency of this proceeding, the Commission issued interim requirements, but not final regulations, pertaining to customer information.[89] These interim requirements include, *inter alia*, the obligation that suppliers disclose the source and fuel mix of their supply. This requirement will ensure that customers receive basic information about the sources of their supplier's electricity. This policy also includes the requirement that suppliers verify specific environmental claims.[90] The latter requirement should supplement commercial law in protecting consumers from fraudulent environmental claims.

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[88]66 Pa.C.S. Section 2807(d)(2).

[89]1997 Interim Requirements for Customer Information, Docket No. M-00960890F0008.

[90]1997 Interim Requirements for Customer Information, Docket No. M-00960890F0008, Appendix B, Section III.C.6

The Commission should be applauded for joining the other pro-active states of Vermont, Massachusetts and Maine in including mandatory disclosure provisions as an element of the electric industry restructuring. This policy provides an excellent foundation upon which to build a comprehensive environmental disclosure process.

In this section of the brief, the Environmentalists propose a modest extension of the Commission's interim requirements. Environmentalists' testimony in this case speaks to the need to address additional aspects of informed customer choice; namely, the need for disclosure of key air and other waste emissions to consumers in a standard and easy to comprehend label. These requirements should pertain to all suppliers selling into the PP&L service territory, if not the entire state of Pennsylvania.

Extension by the Commission of its interim requirements to add of environmental disclosure would represent sound public policy for the following reasons:

- Electricity generation has a tremendous environmental footprint, accounting for roughly two-thirds of all SO_2 emissions, nearly one-third of total NO_x emissions, and more than one-third of total CO_2 emissions. Electricity generation is responsible for a host of other land-, water- and air-related environmental costs and risks. These environmental considerations are related to, but not entirely addressed by fuel mix disclosure;

- Survey data reveals that many consumers are interested in the environmental implications of their purchasing decisions, and would be willing to pay more for electricity from less harmful sources;

- Many electricity suppliers are positioning themselves to fill the "green power" niche. Many suppliers are interested in marketing a clean product. Unfortunately, others will be green in name alone. Mandatory disclosure of environmental attributes will (1) allow verification of claims; (2) provide customers with information on "dirty" suppliers, and not just those who

make environmental claims; and (3) make comparisons between suppliers easier;

- In order for customer choice to be most meaningful, customers should have basic information about the suppliers in a standardized, easy-to-understand format. Fuel mix and environmental information can be disclosed along with standardized information on price and price volatility.

- The fuel mix disclosure requirement already endorsed by the Commission will require a system of tracking transactions to attribute generation at power plants to sales at retail. As pointed out by Mr. Biewald, it is a relatively simple (and inexpensive) matter to extend the fuel mix disclosure system to key environmental attributes, since the basic protocols for tracking will be in place.

In sum, the Commission should require all retail suppliers to provide accurate, verifiable and uniform information about the sources and environmental impacts of the power they sell. The generation of electricity has tremendous impacts on the environment and customers are interested in the environmental implications of their electricity purchases. The Commission should not simply rely on commercial law to protect consumers from fraudulent claims. Rather, it should take affirmative steps to ensure that every supplier provides customers with uniform and reliable information about the power they purchase. Only in this way can the Commission ensure that customers can make informed and meaningful choices in a competitive marketplace.

The Commission Should Require Retail Sellers to Disclose the Environmental Characteristics of the Power They Sell.

At a minimum, the Commission should require retail suppliers to disclose the fuel mix and emission rates (lbs/MWH) of NO_x, SO_2 and CO_2 of the power they sell. Most

power generators must report emissions data for these substances and will have the information readily available to supply to retail sellers for the purpose of compliance with a disclosure requirement. To the extent that other major environmental impacts, such as waste creation, can be quantified, these should be included as well. A standardized point of comparison, such as the regional average level of pollution per kWh, should be indicated for reference. As discussed in the Regulatory Assistance Project report which was an exhibit to the Biewald testimony, much good work is taking place around the country on this issue. Whether in the restructuring Order or the generic proceeding, emission and waste information should be added to the consumer information requirements.

XII. MISCELLANEOUS ISSUES

As a way of answering the question what do the people of Pennsylvania get in exchange for allowing Duquesne to recover a fair portion of it stranded, the Environmentalists have proposed three new initiatives to be undertaken for Duquesne's customers.

A. The Sustainable Development Fund

1. Introduction

Since the PECO securitization proceeding, the Environmentalists have been advancing a proposal to the Commission for a Sustainable Development Fund to

finance and promote energy conservation and efficiency, renewable energy and other clean-energy technologies. While a large part of the restructuring proceeding is looking backwards and charging ratepayers billions of dollars for past mistakes, we should also be looking forward and making a modest investment in Pennsylvania's sustainable energy future.

2. The Mission and Structure of the Sustainable Development Fund

Environmentalists' witness David Schoengold presented the Environmentalists' proposal for the Sustainable Development Fund.[91] The purposes of the Fund are summarized in the box below.

The Mission of the Sustainable Development Fund

- to support energy efficiency, clean distributed generation and renewable technologies
- to support economic development projects which promote clean energy
- to support cost-effective clean energy alternatives to distribution system upgrades
- to develop reasonable interconnection standards and other important sustainable energy policies
- to review and publicize power plant emission and waste data
- to encourage clean energy supplies in the generation mix offered to Pennsylvania customers
- to encourage energy efficiency and renewable energy resource technologies to locate in Pennsylvania

[91] Environmentalists' Statement No. 1 (David Schoengold), p. 8, l. 28 to p. 9, l. 8.

3. The Budget of the Sustainable Development Fund

The Environmentalists propose that the Sustainable Development Fund be financed by all suppliers through an annual contribution equal to 1% of their gross revenues. On a statewide basis, this would provide annual funding of approximately $22 million. By way of comparison, the Clean Energy initiative of the Long Island Power Authority is very similar to the Sustainable Development Fund and its annual budget is $32 million.[92]

B. The Million Solar Roof Program

The Million Solar Roof Program is a joint effort of the U.S. Department of Energy ("DOE") and the Utility Photovoltaic Group ("UPVG") to accelerate the commercialization of photovoltaic systems. *The Environmentalists recommend that the* Commission direct Duquesne to become a full partner in this important program and to offer financing for the installation of such systems by its customers at an interest rate 0.5% higher than its cost of capital.[93]

C. The Conservation Loan Fund

The Environmentalists recommend that Duquesne establish an energy loan program to help its residential customers make energy efficiency improvements to their

[92]Environmentalists' Statement No. 2 (Bruce Biewald), p.15, l. 11-20.

[93]Environmentalists' Statement No. 1 (David Schoengold), p. 8, l. 21-26.

existing or new facilities. Loans would be given priority on the basis of electricity savings, system reliability benefits, customer class contributions and need. The Loan Fund would receive an initial capitalization from Duquesne at a level equal to 2% of the Company's stranded cost recovery.[94]

D. Environmental Comparability

In order to create a level playing field for all market participants, the Commission should implement uniform environmental standards that all retail suppliers must meet in order to sell power in Pennsylvania.[95] At present there is considerable disparity between the emission standards applied to generating units of different vintages or located in different states or regions. Restructuring could have a dramatic impact on the air quality in Pennsylvania if it encourages generators of relatively dirty power who are subject to less stringent environmental regulations to increase production.

The Commission Should Implement Uniform Environmental Standards in Order to Ensure Fair Competition among Generators.

The Commission must ensure that the introduction of competition to the electric industry in Pennsylvania does not result in dirtier air and the attendant harm to the environment and public health. In the absence of uniform federal emission standards,

[94]Environmentalists' Statement No. 1 (David Schoengold), p. 9, l. 10-27.

[95]Environmentalists' Statement No.1 (David Schoengold), p. 3, l. 26 to p. 5, l. 17.

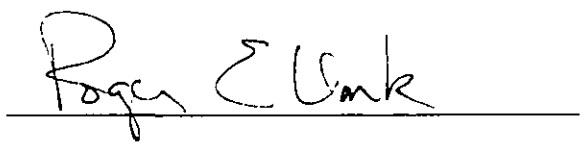
the Commission should require all retail sellers to ensure that the power they sell in Pennsylvania has been generated by plants that meet the state's most recent environmental standards.

XIII. CONCLUSION

The Electricity Generation Competition and Customer Choice Act recently celebrated its first birthday. Since it was passed, everyone knew that many of the monumental decisions would fall on the Commission. The Environmentalists have shared, as best we can, our vision for the job ahead. It is now the Commission's task to create the marketplace where the residents and the businesses of Pennsylvania have access to adequate, safe, clean, reliable and efficient energy services at fair and reasonable prices at the lowest long-term cost to society.

Respectfully submitted,

Attorney for the Environmentalists
by:



Date: February 10, 1998

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The Environmentalists' Vision for the New Electricity Marketplace

Fundamental Goal

The fundamental goal of restructuring is to provide a marketplace where consumers have access to adequate, safe, clean, reliable and efficient energy services at fair and reasonable prices at the lowest long-term cost to society.

Public Interest

The marketplace will provide energy services which minimize the long term cost to society rather than maximize the short term monetary gain. The marketplace will not simply be a frenzy for the next cheap kilowatthour, but will also promote public interest concerns such as the environment, public health, universal service, energy security, local economic development, etc. An industry that continues to shift environmental costs to the public is not efficient. Structural changes will be encouraged when they result in improved economic efficiency and serve the broader public interest. Barriers to utilizing life cycle economic analysis will be minimized. Industry/community partnerships will be strengthened to promote such things as energy efficiency in housing and community development.

The public benefits of energy efficiency, renewable resource technologies and research and development should be maintained through existing and new mechanisms. Energy efficiency, renewable resource technologies and research and development provide significant economic and other benefits for Pennsylvania and are critical to achieving a long-term sustainable and efficient electricity future.

Robust Market

The potential for competition to improve economic efficiency and to reduce long-term costs rests on having robust competition in the marketplace. Robust competition requires *multiple service* providers in the marketplace in order that customers have real choice. All power generation will face full and fair competition. The utilities will not enjoy competitive advantage, either through massive stranded cost war chests or other anti-competitive actions. There will be no unreasonable barriers to entry into the marketplace. Market development will be guided in a way that increases the role of competition among energy service providers and the role of choice for customers. The concentration of ownership of generating capacity in the marketplace will be limited in order to minimize opportunities for abuse of market power.

Shared Benefits

Electric industry restructuring is done in a way that benefits all customer classes fairly and does not unduly disadvantage any customer class nor preserve any undue cross-class subsidy. Mechanisms will be developed which enable small users to enjoy the same benefits of the marketplace as large users.

Consumer Choice

Consumers will have the opportunity to make informed choice among electricity providers and services. The marketplace will provide power choices equitably among consumers and customer classes. Similar choices should be available to all consumers under similar terms and costs. There will be no captive customers, either as a result of institutional arrangements or on a *de facto* basis as a result of lack of interest on the part of suppliers to serve certain consumers or groups of consumers.

Consumer Information and Education

Consumers are provided with information concerning their energy purchases that is factual, objective, and understandable, so they can make informed choices. This information includes objective data on the mix of generation sources as well as air and water emissions and other waste generation. This

information is in all promotional materials and billing statements in an easy-to-understand label.

Consumer Protection

Consumers are protected from anti-competitive behavior, undue discrimination, poor service and unfair billing and disconnection practices. The marketplace is obligated to connect and provide service to customers on reasonable terms available to all customers.

Universal Service

Because electricity is vital for health, safety and economic opportunity, universal energy services will be available at just, reasonable and affordable rates to all households needing assistance. Appropriate assistance will be flexible and targeted to include energy conservation, bill payment assistance, budget counseling, energy education, renewable energy and other tools to enable all Pennsylvanians to afford a reasonable level of energy services. Permanent energy assistance in the form of energy conservation will be a strong part of the universal service strategy. Universal service programs will be credited with the savings they cause in collection costs and bad debt write-offs.

In order to leverage additional resources and to maximize their effectiveness, universal service programs will be offered in a broader context of human services through community-based providers.

Network Integrity

The safety, reliability, quality and sustainability of electric service will be maintained or improved in a restructured electric industry. Market-based decisions, driven by economics and competition alone, could jeopardize critical safety and reliability of long-term strategic resource and facility planning. Public policy should ensure the integrity of the electric grid and encourage prudent long-term resource planning, acquisition and utilization.

There will be open interconnection access with the grid in a transparent and user-friendly process. The utilization of distributed energy systems will be facilitated through such strategies such as net metering for small-scale renewable and clean energy systems. The grid will be operated by a truly Independent System Operator (ISO), providing open access to the transmission system to support a vigorous and competitive power market.

The distribution system will use integrated targeted area resource planning to determine the least cost strategies to upgrade the distribution system. Building more lines will be the option of choice only when it is cheaper than the other alternatives. Parties implementing conservation or distributed energy which benefits power flows on the distribution system and avoids or postpones upgrades will receive some of the savings they have made possible. The same will be true for the transmission system.

Stranded Costs

The consideration of stranded costs will seek to balance the ratepayers' expectations of access to the benefits of restructuring and competitive energy supplies and services with the shareholders' reasonable expectations of an economic return. The analysis will involve a three step process of (1) the identification and quantification of the stranded cost claim, (2) the review of the adequacy of each utility's efforts to mitigate its stranded costs, and (3) the appropriate sharing of the stranded costs between ratepayers and shareholders.

Decommissioning costs will be adequately funded in a manner that is fair and efficient. Nuclear plant operators will be responsible for some portion of the decommissioning costs and will have an interest in controlling those costs.

Dated: June 18, 1997

Brief of the Environmentalists
Appendix B

The only specific stranded cost number advanced by the Environmentalists is the stranded generation asset recovery fraction of 60% advanced by David Schoengold in Environmentalists' Statement No. 1. The dollar impact of this recovery fraction depends on the final figures determined for the nuclear and fossil generation asset stranded costs.

The applicable portion of the Summary Table is shown below:

SUMMARY OF
STRANDED COSTS
($000)

	Company Claim	Adjustment	Adjusted Amount
Nuclear		60% × X, with X being the approved nuclear stranded cost figure	Depends on the value of X
Fossil		60% × Y, with Y being the approved fossil stranded cost figure	Depends on the value of Y