COMMONWEALTH OF PENNSYLVANIA

KJR

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February 10, 1998

ORIGINAL

James J. McNulty, Secretary
Secretary Bureau
Pennsylvania Public Utility Commission
Room B-20, North Office Building
P. O. Box 3265
Harrisburg, PA 17105-3265

DOCUMENT FOLDER

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 please find an original and nine (9) copies of the Office of Consumer Advocate's Main Brief in the above-captioned proceeding.

Because of the voluminous nature of the unpublished orders cited in the OCA Main Brief, copies are being provided only to the presiding ALJ, and not to all parties listed on the service list. Copies are available to any party upon request.

Copies have been served on all parties of record as shown on the attached Certificate of Service.

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Sincerely,

Marisa A. Sifontes

Marisa A. Sifontes
Assistant Consumer Advocate

Enclosure
cc: All parties of record
Honorable John H. Corbett, Jr. (Via overnight mail)

33

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

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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OFFICE OF CONSUMER ADVOCATE'S
MAIN BRIEF

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Dated: February 10, 1998

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

On August 1, 1997, pursuant to Section 2806 of the Electricity Generation Customer Choice and Competition Act ("Customer Choice Act" or "Act"), 66 Pa.C.S. § 2806, Duquesne Light Company ("Duquesne," "DLC" or "Company") filed its proposed Restructuring Plan and tariff changes necessary to implement that plan.

On August 28, 1997, the Office of Consumer Advocate ("OCA") filed a Formal Complaint in connection with the proposed restructuring plan. Numerous other parties have filed Formal Complaints or intervened in these proceedings and, like OCA, have presented alternative recommendations with respect to virtually every material aspect of the restructuring plan.

This Main Brief presents the Office of Consumer Advocate's position on the issues presented in this proceeding. The issues are both controversial and important, requiring consideration of the most effective means to introduce competition into the market for electric generation services while, at the same time, ensuring that the competitive market brings with it real, informed choice to consumers, ensures that customers who are unable to, or choose not to, obtain competitive services continue to receive generation services at just and reasonable rates, and balances ratepayer and shareholder interests with respect to sharing the costs and benefits of restructuring the role of the utility as a provider of generation services.

The Commission recently addressed many of the issues which are also being addressed in this proceeding in its Opinion and Order in PECO Energy Company's Restructuring proceeding and the related Petition of Enron Energy Services. Application of PECO Energy for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement, R-00973953, slip op. (December 23, 1997) ["PECO Order"], as modified on reconsideration, slip op. (January 16, 1998) ["PECO Reconsideration Order"]. Duquesne Light's restructuring plan, however, differs in a number of significant respects from PECO's plan, and OCA expects that Duquesne will argue that, in light of such differences, the Commission should adopt a different approach from that taken in the PECO Order. OCA submits, however, that the PECO

Order provides substantial guidance on many key issues related to restructuring.

The PECO Order adopted, either explicitly or implicitly, positions in that case which are consistent with OCA's position in this case in numerous respects. These include:

- Determination of stranded costs on a Net Present Value basis at January 1, 1999, PECO Order at 80;
- OCA witness Doug Smith's market price projections, underlying the stranded cost computation, PECO Order at 88;
- Adoption of OCA's market value for generating assets, which included savings produced by productivity enhancements and life extension of plants, PECO Order at 88;
- Rejection of Company claim for fossil decommissioning costs, PECO Order at 91-92;
- Allocation of stranded costs to each class based on production plant allocator in last base rate case, PECO Order at 109-110, 112, 120-21;
- Determination of the Competitive Transition Charge ("CTC") based upon the allocated level of stranded costs for each class, PECO Order at 109-110;
- Collection of full share of stranded costs from all customers, i.e. no cost shifting based on 1997 sales, with reconciliation of actual CTC revenues on a class basis, PECO Order at 112;
- Establishment of Transmission and Distribution rates as recommended by OCA witness Lee Smith, PECO Order at 59;
- Adoption of an approach to consumer education which includes both a state-wide customer education program and a local customer education program supplemented through the use of community based organizations ("CBOs"), PECO Order at 148-57;
- Submission of a detailed local consumer education plan in the compliance filing, PECO Order at 155;
- Expansion of universal service programs, the inclusion of a renewables pilot program, and use of CBOs in the implementation and administration of such programs, PECO Order at 146-48;
- Implementation of numerous consumer protection initiatives recommended by OCA witness Alexander, including treatment of customer terminations and fees for switching suppliers. PECO Reconsideration Order at 17.

Clearly, the PECO Order provides a foundation that, in large part, provides an appropriate and reasonable resolution of many of the difficult issues presented to the Commission that should be followed in this case. In particular, Duquesne's plan in this case would postpone a final determination of stranded costs until the year 2003, and continue rates in effect at their current high

levels, unless it appears at an earlier date that the Company's mechanism will overrecover stranded costs. OCA strongly opposes this plan because it is contrary to the intent of the Act to establish stranded costs in this proceeding, would unnecessarily postpone such determination, and deprive ratepayers of any of the benefits of restructuring for several years. The Company's approach should be rejected in favor of a stranded cost determination as recommended by the OCA and as established in the PECO Order.

Despite OCA's agreement with many aspects of the Commission's PECO Order, OCA submits that, with respect to certain conclusions, a different result should be implemented with respect to Duquesne's restructuring plan. In particular, the OCA submits that Duquesne's rates should be unbundled in such a way that all customers' rates are reduced, not just the rates of those consumers who can and do leave Duquesne's generation service. The Commission should find that it is inappropriate to establish generation rates which allow Duquesne to recover more than its generation cost of service from customers who either (1) do not have the choice of an alternative supplier, or (2) choose to remain with the utility during the transition period due to the absence of real competition.

Based upon OCA's analysis, the Company has total stranded costs as of 1/1/99 of $1.351 billion, including $1.020 billion in owned-generation stranded costs $330.84 million in regulatory assets, including $18.2 million of other transition costs. OCA submits that the Company should be permitted to recover these stranded costs over the seven-year recovery period provided by the Act but that it should not be permitted a return on the unamortized balance of its owned-generation stranded costs during this period. OCA submits that denial of a return on these assets during the recovery period provides an appropriate sharing of such costs. The Competitive Transition Charge ("CTC") should provide recovery of this level of costs over the period from January 1, 1999 through December 31, 2005. Based upon OCA's calculations, a CTC established at this level will, combined with unbundled T&D rates recommended by OCA and generation prices at market levels based on OCA's analysis, will produce a 16.9% average rate reduction over the next seven years as shown

on the schedules attached to this Brief (Exhibit LS-7 Revised).

The OCA recommends that its market generation rate be used for customers who cannor or do not shop for generation during the phase-in period. After that point, the generation rates charged by Duquesne must be set in accordance with the regulations to be established for determining "prevailing market price" under Sections 2807(e)(2) and (e)(3) of the Act.

Finally, the Commission should adopt OCA's recommendations with respect to customer education, customer protection issues, and universal service programs.

II. PHASE-IN OF CUSTOMER CHOICE

A. Method of Customer Selection

In its restructuring filing, Duquesne has proposed that residential and small commercial customers be selected for phase-in to customer choice by zip code-based geographic areas of choice (GACs) based on interest in the pilot program. Duquesne St. 6 at 3, Duquesne St. 6R St. 9. Other commercial and all industrial customers are to be selected based on SIC code-based market segments so that all customers in that segment will be granted retail access at the same time to avoid competitive disadvantages. Duq. St. 6 at 4. These methods differ from the preferred approach of the first-come, first-served phase-in process contained in the Act. For purposes of this Brief, the OCA will address Duquesne's proposal for residential customers. In addition, the OCA briefly addresses the Environmentalists' Better Choice Plan.

Duquesne has rejected the first-come, first-served selection contained in the Act arguing instead that the Company's approach ensures non-discriminatory eligibility. Duquesne St. 6 at 3. It additionally argues that this approach will allow the company to target its consumer education effort more precisely and allow alternative suppliers to target their marketing more precisely. Duquesne St. 6 at 3, 4.

The OCA submits that Duquesne's method of phase-in by geographic location for residential customers should be rejected and that the first-come, first-served approach should be adopted. As

set forth by OCA witness Alexander,[1] there is no compelling reason to phase-in customer choice for residential customers by geographic area. First, suppliers will typically market throughout an entire service territory, as opposed to the smaller zip code based areas that Duquesne has proposed. OCA St. 5 at 56. Second, Duquesne has not shown that its proposal is fairer to lower socio-economic classes, as the Company asserts. OCA St. 5 at 56. As OCA witness Alexander stated, if there is a problem reaching lower socio-economic classes, then there are more appropriate remedies. For example, Ms. Alexander explained:

> If, as the Company alleges, there is a greater interest in customer choice and competition by higher income customers, this should cause Duquesne to devise a customer education program targeted to lower income customers.

OCA St. 5 at 56-57.

Moreover, the Company's selection of geographic areas based on interest in the pilot program may not be equitable. Ms. Alexander explained the flaw in the Company's approach as follows:

> These communities vary greatly in population density and a quick review of the list of communities recommended for Phases I, II, and III in Mr. Hoffman's Exhibit FAH-3 shows that some communities with over 15,000 volunteers for the pilot are relegated to Phase III because the volunteers are a relatively small percentage of the community's population, while some communities with less than 100 pilot volunteers are recommended for Phase I because these customers represent a large percentage of a very small population. It is not fair for those larger communities to be relegated to a later phase because their population base is large and it would have required a very large group of volunteers to trigger a higher percentage and so qualify for an earlier phase. It is more equitable to allow customers *motivated* to participate in customer choice to be selected without regard to their geographic location.

OCA St. 5S at 1, 2 (emphasis added).

The OCA submits that the method that Duquesne has proposed does not allow for access by the most interested residential customers. Additionally, while pilot participants would be included in the first phase of retail access, other interested individuals in their communities could potentially have to wait until January 1, 2001 to have access to the retail markets. It has already been

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[1] OCA witness Barbara Alexander's qualifications are set forth in OCA Exh. BA-1.

established that there is great interest in participating in the pilot program. Under Duquesne's proposal, many customers who had sufficient interest to sign up for the pilot, but were not selected in the lottery, would have to wait until their community was selected, as opposed to being able to volunteer during the phase-in and potentially be selected for one of the earlier phases.

The Environmentalists have proposed the "Better Choice Plan", which would supplement the phase-in process. Env. St. 2 at 42-58. This plan would accelerate the Company's proposed phase-in timetable and also would provide that if over 50% of Duquesne's customers have not chosen an alternative supplier after the accelerated phase-in, then the remaining default customers would be assigned at random to the suppliers who have obtained customers through the voluntary phase-in, as long as they met a set of conditions contained in Environmentalist witness Biewald's testimony. Env. St.2 at 42-58.

In the PECO Order, the PUC ordered that it would "further consider the proposal of the Environmentalists when it promulgates regulations required by Sections 2807(e)(2) and (3)." PECO Order at 135. The OCA agrees with this result. The Better Choice Plan should be revisited further into the process.

B. Timetable for Phase-In -- Not an OCA Issue

III. TRANSMISSION AND DISTRIBUTION RATES; UNBUNDLING ISSUES

A. Introduction

In this case, based upon an adjusted 1996 cost of service study, Duquesne has unbundled its cost of service into three components in developing rates: distribution, transmission, and generation. Under the Company's approach, which maintains current rate levels in effect, the generation component is the difference between total rates and the Company's calculated cost of service for transmission and distribution based on the Company's claimed rate of return for those services. DLC St. 5 at 9. Transmission service costs were developed based on the allocation methodology preferred by FERC. Id. at 15. Ancillary services were initially classified as transmission and costs associated with line losses were classified to transmission and distribution function. Id.

at 7.

OCA has raised a number of issues in this case concerning the unbundling of rates. First, it is OCA's position that, in contrast to the Company's determination of T&D rates based upon the claimed rate of return, rates should be unbundled based upon the achieved rate of return. Second, OCA submits that costs associated with most ancillary services and with line losses are related to the generation function and should be classified accordingly.

Notably, in the PECO Order, the Commission adopted OCA witness Lee Smith's calculated T&D rates as the one which was closest to the Act's requirements. PECO Order, slip op. at 58-63. The conceptual basis underlying Ms. Smith's T&D rates in PECO and those here are the same in all material respects and OCA's recommended T&D rates should, therefore, be adopted.

B. 1996 Test Year Cost of Service

1. Company Approach To Rate Unbundling.

The Company's approach to unbundling rates begins with its calculation of a revenue requirement equal to the rate cap, reflecting roll-in of the Energy Cost Rate ("ECR"). DLC St. 5 at 8. From there, the Company then calculated transmission and distribution rates based on a functionalized cost-of-service study for the test year and allocation factors which it believes support current rates. For this purpose, the Company utilized an "equalized rate of return approach." Id. at 25. In other words, the Company determined the total cost-of-service for each rate class based upon a system average rate of return.[2]

The Company then took the adjusted 1996 revenue by class as functionalized to transmission and distribution rates in the cost-of-service study and developed transmission and distribution rates based upon these functionalized amounts. Exhibit JAL-1C. Generation charges then were

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[2] The Company made two adjustments to these cost of service study results. First, Mr. Lahtinen explained that the Company adjusted the cost of service study "for the differences in rate of return arising from Duquesne's most recent base rate proceeding." Id. Second, he adjusted it to reflect the roll-in of the ECR into base rates. Id. at 26. The adjusted cost-of-service study results are shown on Schedule JAL-3. However, the adjustments to the cost of service study do not affect the proposed rates in any respect.

established as a residual between adjusted 1996 revenues for the class and the amounts functionalized as transmission and distribution charges. Mr. Lahtinen explained how this was done:

> For those classes where allocated cost of service exceeds base revenues, I have reduced the generation component of unbundled costs to insure that the rate cap is maintained and to avoid cost shifting among rate classes. Where costs are below revenue levels, I have adjusted the generation component to meet, but not exceed 1996 revenues.

DLC St. 5 at 25.

Finally, the Company took the estimated market price charge/credit and deducted it from the total rate cap level in order to calculate revenues to be recovered through the Competitive Transition Charge.

C. Required v. Realized Rate of Return: The Company's Approach To Rate Unbundling Improperly Assumes That The Transmission And Distribution Components Of Rates Are Realizing Different Rates Of Return Than The Generation Component Of Rates.

As explained by OCA witness Lee Smith, the problem with the Company's approach to rate unbundling is that by developing transmission and distribution rates based upon the full cost of service for transmission and distribution charges, including the full rate of return, the Company has improperly assumed that transmission and distribution services have been earning a higher rate of return than generation services. As OCA witness Lee Smith explained in her Surrebuttal Testimony, such an approach is inconsistent with establishing the rate cap for "non-generation charges" at the same level as has previously been approved by the Commission for such services:

> In the most recent rate case, the Commission approved a system rate of return and also class rates of return, which applied to the Company's entire rate base. Since the rate of return applies equally to all types of plant, there was no distinction in the rate of return by function. Thus, for purposes of unbundled rates, return by function should be determined by applying the same rate of return to all plant. This will produce appropriate functional rates by class, even though they were not previously unbundled. The Act clearly specifies that overall non-generation charges will be capped at "the non-generation charges that have been approved by the Commission for such service..."

OCA St. 4-R at 6. Consequently, OCA witness Lee Smith corrected the Company's T&D rates to reflect the achieved return, rather than the claimed return. Id. In adopting OCA's approach to T&D rate design in the PECO case, OCA submits that the Commission implicitly adopted OCA's position

on this issue. PECO Order, slip op. at 59.

In his Rebuttal Testimony, Company witness Lahtinen defended his development of T&D rates based on the claimed rate of return, rather than the earned rate of return, on the basis that Duquesne used this approach in developing rates for its pilot program and in developing rates for transmission and ancillary services on file with the FERC. DLC St. 5-R at 36. He also claims that because the Commission did not allow an equity return on certain generating plants in the Company's last base rate case, it implicitly provided a lower rate of return on generation which would justify this differential allocation. Id. at 36-37.

OCA submits that neither of the Company's justifications stand up to scrutiny. Clearly, the fact that the Company has filed rates on this basis in other proceedings does not justify the unbundling of rates on that basis in this proceeding. Second, with respect to the Commission's denial of an equity return on Beaver Valley 2 and the full return on a portion of the Elrama units in the Company's 1987 base rate proceeding, the Company's arguments are inconsistent. Pa. PUC v. Duquesne Light Co., 66 Pa. PUC 518, 651-52 (1988). On the one hand, the Company argues that rates were not unbundled and that the rates of return allowed were, therefore, indistinguishable. Id. at 36. On the other hand, it argues that the Commission implicitly provided for a different rate of return on generation because of the disallowance on this investment. Id. at 37. Furthermore, the Company fails to make a critical distinction: the Commission's disallowance of an equity return on Beaver Valley 2 and the full return on a portion of Elrama was clearly based on its view that those units were not excess capacity. The issue of the return on that investment should be addressed in the context of the determination of stranded costs, not in the context of functionalizing costs between T&D and generation. The Company's arguments on this issue should be rejected and OCA's, OSBA's, and DII's approach adopted. See OSBA St. 1 at 3-10; DII St. 1 at 41-42.

D. Distribution Losses

Since a certain amount of electricity is lost during transmission and distribution of electricity, it is necessary to generate more electricity to meet a specified load than would be required if there

were no need to move the electricity from one place to another. OCA St. 4 at 5. Duquesne, as an example, generally has to generate 105 kWh in order to deliver 100 kWh. Thus, it has 5% distribution line losses. Id. The Company initially included the costs associated with distribution losses in its T&D rates. DLC St. 5 at 12. OCA opposed this, asserting that these costs should be in the generation function, as they historically had been. OCA St. 4 at 6. In his Rebuttal Testimony, Company witness Lahtinen conceded this issue, pointing out, however, that the generation capacity costs associated with providing line loss service will have to be added to the Company's other stranded costs in order to recover them. DLC St. 5-R at 22. OCA agrees and OCA's and the Company's stranded cost calculations reflect this revised functionalization of costs. OCA St. 4-R at 3-4.

E. Ancillary Services: The Company Improperly Functionalizes Ancillary Service Costs As Transmission And Distribution Costs When They Are Generation Costs.

The Company incurs costs to provide certain services, which have been referred to in this proceeding as "ancillary services." As denoted by the Federal Energy Regulatory Commission, these ancillary services include Scheduling, Dispatch and Control Service, Energy Imbalance Service, Reactive Power and Voltage Control Service, Regulation and Frequency Control Service, Operating Reserves-Spinning, and Operating Reserves-Supplemental. DLC St. 5 at 18-19; OCA St. 4 at 3. While a number of these services are actually provided by generating units as is clear from Mr. Lahtinen's testimony, the Company made a number of adjustments to functionalize some of the costs as transmission and distribution costs. Id.; Exh. JAL-1C, p. 3. Specifically, the Company made adjustments to functionalize as transmission costs $4,021,675 for Reactive Power, $5,187,040 for Regulation and Frequency Control and $8,913,265 for Operating Spinning Reserve, or a total of $18,121,980. Id. These adjustments are clearly shown on Mr. Lahtinen's Exhibit JAL-1C, p. 3 of 6.

In his Direct Testimony, Company witness Lahtinen explained that Duquesne's proposed modifications to the functionalized revenue requirement are made "to tailor ancillary service rate

design to accommodate retail choice" and Mr. Lahtinen indicated the Company's intent to seek FERC approval of these modifications. DLC St. 5 at 19.

OCA disagrees with the proposed adjustment to shift these costs from generation to transmission. As OCA witness Lee Smith testified, the costs associated with these adjustments were estimated as portions of the revenue requirement associated with generating units estimated to be required to provide these services. OCA St. 4 at 4. For example, she explained:

> . . . 43 MW of fossil-fuel generating capacity was assumed to be necessary to provide regulation and frequency control response for the Duquesne control area, so the equivalent percentage of fossil plant was determined and this percentage of the fossil plant revenue requirement was defined as the cost of this ancillary service.

Id.

In light of the fact that these costs are clearly associated with generating units, OCA witness Lee Smith removed the adjustment by which the Company moved these costs from the generation function to the T&D functions. Thus, T&D costs of $285,417,000, before the Company's adjustments for ancillary services, are reflected on Ms. Smith's Exhibit LS-4.

In his Rebuttal Testimony, Company witness Lahtinen testified that to the extent these services can be competitively procured, the costs should be reflected in the generation function and proposed a market-based credit to be added to the CGC. DLC St. 5-R at 18-20. However, it is unclear to what extent, if any, the Company has modified its adjustment to T&D rates to reflect the procurement of these services on a competitive basis. In her Surrebuttal Testimony, OCA witness Lee Smith testified that most of the services should be able to be purchased competitively:

> Competitive suppliers could provide most ancillary services. The Company's own testimony states that energy imbalance service and regulation and frequency control can be provided by other suppliers through dynamic scheduling; essentially by running an alternative control area. Currently ECAR requires that spinning reserves be provided from within the control area. That rule is subject to change, and spinning reserves could be provided within the control area by either purchasing existing generation or by building new generation within the area. Thus, it appears that only scheduling and reactive power services are unlikely to be provided through the competitive market.

OCA St. 4-S at 2. As set forth above, OCA disagrees with the Company that these costs should be

reflected in T&D rates. The Company's T&D costs should, therefore, be adjusted as proposed by OCA. OCA has properly reflected this adjustment by putting these amounts back into generation.

F. Voltage-Differentiated Rates -- not an OCA issue

G. Other Issues--Not applicable to OCA

H. Conclusion

In light of the above discussion, OCA submits that transmission and distribution rates should be unbundled as set forth in OCA witness Lee Smith's testimony. As reflected on Exhibit LS-7 Revised (attached), the resulting average T&D rate is 2.21¢/kWh, which reflects a correction to add back gross receipts tax which had mistakenly not been included in Ms. Smith's Surrebuttal schedules.

IV. TRANSITION OR STRANDED COSTS

A. Overview of Stranded Cost Valuation and Recovery Approaches

1. Introduction

A crucial part of the Commission's decision in this case will be its disposition of stranded cost issues. As defined in the Act, "transition" and "stranded costs" are synonymous and denote an electric utility's "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. The Act indicates further that the term includes a range of costs that may not be able to be recovered in a competitive generation market, including stranded costs associated with the utility's net plant investment in generating facilities ("owned-generation stranded costs"), generation-related regulatory assets, the unfunded portion of nuclear plant decommissioning costs, cost obligations under contracts with nonutility generating ("NUG") projects, costs related to cancellation, buyout, buydown or renegotiation of nonutility generating projects ("NUG buyouts"), and "other transition costs," which include costs of employee severance, retraining,

early retirement, outplacement and related expenses at reasonable levels for employees affected by changes that occur as a result of restructuring. Id.

Numerous issues have been presented in this proceeding regarding the identity of recoverable stranded costs and their quantification. These issues are discussed in detail below. However, in light of Duquesne's novel proposal to postpone a final valuation of stranded costs until the year 2003 and to maintain its rates at current levels, it is critical at the outset to discuss the different approaches to stranded cost valuation and recovery.

As discussed below, Duquesne proposes to postpone final valuation of stranded costs until the year 2003, to maintain rates at current levels until 2005 unless the final valuation indicates that rates should be lowered, and to reflect any earnings in excess of the allowed rate of return as credits in such final valuation ("ROE spillover"). This proposal is premised on Duquesne's view that it is not possible for the Commission to determine a "known and measurable" level of stranded costs in this proceeding, on Duquesne's forecast that, even at capped rate levels, it will still have stranded costs at the end of the CTC recovery period, and on its view that the Commission cannot lower rates if it determines that any excess earnings are being utilized to amortize stranded costs. Alternatively, in its Rebuttal and Rejoinder Testimonies, the Company has indicated its willingness to divest its generating assets if it does not merge with Allegheny Power Systems as is expected.

OCA opposes Duquesne's final valuation and rate cap/ROE spillover proposals and submits that they should be rejected in favor of a one-time determination of stranded costs in this proceeding, a sharing of stranded costs by amortizing stranded costs over a seven-year period without allowing a return on the unamortized balance of the Company-owned generating assets. As discussed below, Duquesne's proposals should be rejected because they are inconsistent with the Act, provide no near-term rate relief to consumers, are administratively burdensome, would interfere with the competitive market, would interfere with the Company's incentive to mitigate stranded costs, and would require ratepayers to bear the entire stranded cost burden of the significant amount of uneconomic excess capacity currently held by the Company. Additionally, OCA would emphasize

that the 11.5% ROE on which the Company's proposal is based is far too high and that it would be practically impossible to determine earnings as part of its ROE spillover proposal when the Company has one foot in the competitive market.

With respect to the Company's alternative divestiture proposal, while OCA agrees that a divestiture provides perhaps the best means of establishing the market value of plants and the stranded costs associated with them, Duquesne's proposal in this regard is made only in the context of non-consummation of the merger. Without a final decision on the merger, it is impractical to further consider this alternative.

2. Duquesne's Approach

a. Introduction

The PECO Order provided for a quantification of PECO's stranded costs at this time and recovery of those stranded costs over an 8 ½ year CTC recovery period. Duquesne's approach to stranded cost recovery is completely different and consists of two main components:

- Continuation of current rate levels, with the difference between the rate cap, T&D rates, and market-priced generation used to amortize/mitigate stranded costs until a future date of final stranded cost valuation, i.e. (Rate cap - T&D - market-priced generation = stranded cost amortization);

- Final valuation of stranded costs in 2003 by an arbitration panel, subject to review by the Commission. Further, an adverse determination by the Commission (lower stranded costs than determined by the arbitration panel) can be superseded by a divestiture of assets by Duquesne. Final valuation may be advanced if market prices are higher than expected, resulting in more rapid amortization of stranded costs.

Underlying Duquesne's approach are two key principles. First, Duquesne's proposal for continuation of the current level of rates until the final valuation is based on its interpretation of Section 2804(4)(v) of the Act, which it interprets as allowing electric utilities to charge rates up to current levels provided that "any excess earnings achieved under the cap are being utilized to mitigate transition or stranded costs for the benefit of ratepayers." Id. Since Duquesne's calculations indicate that if rates are maintained at current levels and all revenues that are not utilized to cover transmission and distribution costs and generation costs at market prices are utilized

to mitigate (or amortize) stranded costs, it will still have stranded costs at the end of the transition period, it contends that it meets the requirements for continuation of rates at their current levels. Second, Duquesne's approach is in accordance with its view that a final valuation in 2003 will result in stranded costs being based on"objective" market evidence, rather than on market price forecasts. Id. at 14-15.

OCA submits that, for a number of reasons, Duquesne's approach must be rejected in favor of the approach utilized by the Commission in the PECO case.

b. Duquesne's Approach Is Inconsistent With The Act's Requirement That Stranded Costs Be Determined In This Restructuring Proceeding.

The first problem with Duquesne's approach is a legal one. OCA submits that the Act requires that stranded costs be determined in this restructuring proceeding. Thus, a future valuation of stranded costs is inconsistent with the Act. This is made plain in the definitional section of the Act where "Transition or stranded costs" are defined as the utility's net electric generation-related costs "determined on a net present value basis . . . as part of its restructuring plan." 66 Pa.C.S. § 2803. OCA submits that the requirement in the Act for a determination of stranded costs in the restructuring plan on a net present value basis is a clear requirement for a one-time determination of stranded costs in this proceeding.

c. Duquesne's Argument That A Stranded Cost Determination In This Proceeding Violates The Known And Measurable Standard Is Without Merit.

The Company's argument that the Act requires the Commission to determine the "known and measurable" level of stranded costs, and that such a determination cannot be made in this proceeding, is simply wrong and suggests that the PECO Order is in contravention of the law. DLC St. 1 at 14. As OCA witness Kahal explained, while performing market valuations on long-lived plants is a difficult undertaking, the same will be true in 2003 when Duquesne proposes that such a valuation be made. OCA St. 1 at 12. Thus, in its PECO Order, the Commission found that its stranded cost determination was known and measurable. PECO Order, slip op. at 100.

d. Duquesne Misinterprets Section 2804(4)(v) As Requiring The Commission To Allow Continuation Of Current High Rate Levels.

OCA also submits that Duquesne misinterprets Section 2804(4)(v) of the Act to allow the Company to maintain its rates at the level in effect at the effective date of the Act if the Commission determines that excess earnings are being utilized to mitigate stranded costs or to offset other known and measurable cost increases that would be recoverable under traditional ratemaking and are not included within the capped rates. OCA submits that the intent of this section which is included in the rate cap provisions of the Act, was to preent complaints against current rates after the Company's restructuring had been completed, not to prevent rates from being lowered in the Company's restructuring case. The Company's interpretation of this provision stands the entire restructuring proceeding on its head and would defeat one of the primary goals of the Act, to provide needed rate relief for Pennsylvania consumers. Moreover, as OCA's analysis demonstrates, even after amortizing an appropriate amount of stranded cost, the Company's rates require adjustment to reflect savings to all customers.

e. The Company's Proposal To Defer Final Valuation Of Stranded Costs Will Not Dispel The Uncertainty Of Measuring Stranded Costs Or Otherwise Benefit Ratepayers.

In addition to the absence of a legal basis for the Company's proposal, its proposal suffers from a number of other problems. First, while the primary reason for the Company's proposal is that there is too much uncertainty to reliably estimate stranded costs, it is simply inappropriate to assume that this uncertainty will be dispelled over the next several years and that an "unbiased" arbitration panel will be able to reach a better valuation of stranded costs. See OCA St. 1 at 12. As Mr. Marshall recognized on cross-examination, even if the arbitration panel makes its decision on the basis of market evidence in 2003, such as forward contracts, that decision will still be based on estimates -- except that they will be investor estimates, rather than market analyst estimates. Tr. at 29-30. Moreover, there is no guarantee that a futures market will develop by 2003 that will provide market data throughout the life of asset period for which market price projections must be made in

this case.

Second, the interim establishment of the market price through an auction process may result in a depressed market price proxy, leading to overstated CTC charges at ratepayers' expense and to Duquesne's benefit. Id. As OCA witness Kahal testified, a "passive wholesale auction, with no price negotiation is hardly consistent with the aggressive marketing and revenue maximization" that could be expected in a genuine competitive market. Id. at 13. Especially if Duquesne's retail customers are unable to purchase their power supply at these auction prices, then the auction pricing procedure is of questionable merit in establishing market price. Id. It is difficult to believe, for example, that retail customers will be able to purchase electricity at the 1.856¢/kWh that is reflected in Mr. Lahtinen's Customer Generation Credit. DLC Exh. JAL-11.

Third, as Mr. Kahal testified, Duquesne's proposal eliminates the possibility of any rate savings for customers during the CTC recovery period, a fact which is extremely problematic given Duquesne's very high rates and its own recognition that rates during this period will exceed its standard cost of service by a substantial amount. Id. More specifically, Duquesne witness Clayton forecasted the need for $259 million of accelerated depreciation and $175 million for acceleration of the Beaver Valley 2 lease in order to reduce the return on equity to 11.5% during this period. OCA St. 1 at 14. This accelerated depreciation is on top of $180 million in accelerated depreciation of the Perry nuclear plant resulting from the 1996 Ft. Martin settlement and another 1995 initiative. Id. at 14-15. Reducing the return on equity to 10.0% as proposed by OCA would increase the need for accelerated depreciation by $136 million. Id. Finally, OCA witness Kahal pointed out that the Company's financial forecast assumes that three apparently uneconomic plants continue to operate during the transition period. Id. at 15. If these plants do not continue to run, the Company would save more than $200 million in net operating expenses, after accounting for the added cost of purchasing replacement power. Id. Thus, as Mr. Kahal concluded, these various items suggest that the capped rates exceed the "standard" cost of service (i.e., no acceleration, a 10.0 percent ROE and no uneconomic operating costs) by more than $1 billion during the transition period." Given that

Duquesne's rates are the second highest in the state to PECO's, with an average residential rate of 12.2 cents per kWh -- approximately 50% above the national average -- OCA submits that the Company's proposal to not include a rate reduction is simply the wrong approach to restructuring rates under the Act. Id. OCA's approach of reflecting the savings of competition to all customers is a fundamentally more sound approach.

Fourth, as Mr. Kahal testified, a final valuation in 2003 will weaken Duquesne's incentives to mitigate stranded costs and maximize asset value. Id. "Poor cost control performance during the intervening years will show up as reduced market value of its power plants in 2003. Ratepayers will incur at least some of that risk under Duquesne's plan." Id. Indeed, the intended division between that portion of Duquesne's operations which are regulated and that which is unregulated will not occur since performance at the Company's generating units will affect the final valuation of stranded costs. This is particularly of concern since continued operation of a number of Duquesne's generating units would appear to be uneconomic. Since the final stranded cost valuation will depend on whether the Company retires or continues to operate its generating units, and the efforts that it makes to control costs, the Commission needs to be particularly wary of a final valuation approach, since it will require the Commission to determine the prudence of the Company's management of generating facilities during this period.

f. The Company's Proposed ROE Spillover Mechanism, While Critical To The Company's Proposal, Would Require Annual Reexamination Of The Company's Earnings, Including Earnings Subject To The Competitive Market.

Finally, Duquesne's proposal is premised on its proposed "ROE spillover mechanism" ensuring that all "excess earnings" will be utilized to mitigate stranded costs. Under this proposal, as revised in its Rebuttal case, the Company would flow to ratepayers any earnings in excess of its authorized rate of return.

Despite the importance of this mechanism from the Company's perspective (Tr. at 212), however, the specific operation of this mechanism was not delineated anywhere in the Company's

Direct or Rebuttal Testimony. Finally, on cross-examination, Company witness Clayton testified that he envisioned a once-a-year true-up of the Company's earnings based on its quarterly financial report filings pursuant to Chapter 71 of the Commission's regulations. Tr. at 209-11. Mr. Clayton further testified that while he envisioned a review and comment process, it would be appropriate to allow parties to perform discovery and cross-examine witnesses for purposes of determining the earnings subject to the ROE spillover mechanism, and that it would be appropriate that the Company would bear the burden of proof to justify its numbers. Tr. at 365-66.

The problems with this proposal are numerous and require rejection of Duquesne's entire approach to valuation and recovery of stranded costs. First, Duquesne's proposal would require annual reexamination of the Company's returns on capital, as indicated by Mr. Clayton. Tr. at 209-11. In OCA's view, this would, for all practical purposes, require a ratemaking review of the Company's earnings on an annual basis, with provision for discovery and hearings to examine Duquesne's numbers. While one would hope that this review could be limited in nature, the need to preserve parties' due process rights might result in substantial differences of opinion over the Company's earnings and require substantial expenditure of administrative resources.

Second, Duquesne's proposal contemplates the review of Duquesne's earnings on a total company basis, including a review of its generation earnings, which would be subject to the competitive market. Tr. at 212-13. OCA submits that it is the intent of the Act to establish market-based generation rates, subject only to the limitations of the generation rate cap and provider of last resort service. The Company's ROE Spillover proposal, however, would require a continued regulatory return review.

In this respect, the Company's performance in the competitive generation market would directly impact on the Company's earnings. Thus, if, for example, the Company operated generating plants which were uneconomic to operate, the Company's imprudence would impact on its level of earnings and its imprudence in the generation market would have to be reviewed. Tr. at 213-14. This is a very real prospect in light of the uneconomic state of a number of the Company's plants,

including its nuclear units.

Third, as OCA witness Kahal testified, the Company could effectively evade an overearnings finding by using such "excess earnings" to fund marketing efforts or offer rate discounts associated with unregulated market transactions. OCA St. 1 at 12.

In light of these considerations, OCA submits that the Company's proposed ROE Spillover mechanism is inconsistent with the Act's objectives of reducing regulation and raises more problems than it resolves.

g. Duquesne's Divestiture Proposal.

In its Rebuttal case, Duquesne proposed as an alternative to its final valuation proposal that, if directed to do so by the Commission, it would divest its generating assets in 2003. As OCA witness Kahal pointed out, however, this proposal retains the shortcomings of the Company's original proposal since it rules out any rate relief for retail customers for six years or longer, and delays the quantification of stranded cost. OCA St. 1-S at 5.

In its Rejoinder testimony, Duquesne attempted to address these continuing problems by indicating that it would agree to an immediate auction of the Company's generating assets in order to determine their market value as of January 1, 1999. DLC St. 1-Rejoinder at 1-2. The OCA generally agrees that immediate divestiture would provide an appropriate valuation method. However, Duquesne's proposal in this respect is limited to Duquesne as a stand-alone utility and it would not pursue this course of action if the merger with Allegheny Power Systems is completed. Tr. at 24. Thus, this course of action can only be considered in the context of the non-consummation of the merger transaction.

3. OCA's Approach

In contrast to Duquesne's approach, and for the reasons discussed above, OCA proposes a current valuation of stranded costs and recovery of those costs over the seven-year CTC recovery period, except that the Company should not be permitted to recover a return on the unamortized balance of its owned-generation assets (this is discussed in section IV(F)(3)(b)). With that

adjustment, OCA would reduce rates to a just and reasonable level. OCA St. 1 at 14-16. As indicated above, Duquesne's capped rates exceed its "standard" cost of service by more than $1 billion during the CTC recovery period, even before the consideration of merger savings. Id. at 15.

4. Conclusion

In light of the above, OCA submits that the Company's stranded cost valuation and recovery approach should be rejected and that recommended by OCA adopted.

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

1. Introduction

The determination and recoverability of the stranded costs associated with the utility's generating facilities [hereinafter "owned-generation stranded costs"], as specified in the definitional section of the Act, is governed by Section 2808(c)(3) of the Act. That section 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." This language is in contrast to the requirement that the Commission allow recovery of regulatory assets and prudently incurred costs related to cancellation, buyout, buydown or renegotiation of NUG projects. 66 Pa.C.S. §§ 2808(c)(1) and 2808(c)(2).

Because of the discretion given the Commission in determining the level of owned-generation stranded costs which the utility may recover, one of the issues addressed in this section is the recoverability and level of recovery of such costs. The other issue is the quantification of these costs.

First, with respect to quantification, the essential question raised is what is the difference between the market value of the Company's assets and their book value. While book value is a known amount, the market value of those assets may vary dramatically from their book value because of the economics of that investment in the current and expected marketplace. There are two primary ways to value assets: (1) let the market value them -- put them up for auction; or (2) estimate their market value through an assessment of the margins which may be generated from

the assets over their life based on expected market prices, discounted to the present value.

Initially, the Company sought only to determine market value as of January 1, 2006, as part of its approach of evaluating how much accelerated depreciation would be required during the transition period to prevent excess earnings. In its rebuttal case, however, the Company presented an analysis of market value as of January 1, 1999, in the event that the Commission adopted a proposal to determine stranded costs as of that date.

In valuing its assets, the Company used a cash flow or "margins" analysis to calculate the market value associated with each Duquesne generating unit. OCA witness Kahal summarized this methodology as follows:

> The model calculates for each generating unit and each year the market revenue which the unit will provide minus all ongoing operating costs. These costs would include fuel (and related items), fixed O&M, variable O&M, taxes other than income, capital additions (treated as expenses) and an allocation of A&G. The result is a stream of cash flow margins for that unit. Mr. Clayton then takes the net present value (NPV) of that stream and adjusts the NPV total for income taxes.

OCA St. 1 at 18. This NPV of market value is then subtracted from net book value and the NPV of decommissioning costs, to determine stranded costs for each generating unit. Id. A further detail of this approach is that if the margin analysis produces a net negative margin on a present value basis (operating expenses for the plant, including necessary capital additions, exceed market revenue), the negative result is set equal to $0. Id. at 19. In other words, the net book value of that generating unit, together with its decommissioning costs, is the stranded cost of the unit. As OCA witness Kahal explained, this would imply that "continued operation of the plant is uneconomic." Id.

OCA witness Kahal generally did not object to this approach and, for consistency, utilized the same approach to calculate stranded costs with some important modifications. Id. The most obvious difference between the Company's original approach and Mr. Kahal's approach was that the Company's analysis was conducted as of 2006, whereas Mr. Kahal's analysis was conducted as of 1999. Id. In its Rebuttal Testimony, the Company provided an analysis as of 1999, thus facilitating

a more direct comparison between OCA's calculation of stranded costs and the Company's.[3] DLC Exh. DJC-10.

Differences in the results of the analyses are driven primarily by the different market price projections utilized by Duquesne witness Clayton and OCA witness Kahal. Mr. Clayton utilized a range of market prices developed by Company witness Schnitzer. Mr. Kahal incorporates the revenue and fuel cost projections of OCA witness Doug Smith, as well as Mr. Smith's estimates of non-fuel variable O&M.

Additionally, and as discussed further below, Mr. Kahal (1) utilizes a discount rate reflecting a lower rate of return on equity (10.0% as opposed to 11.5%) and removal of debt reacquisition and issuance costs; (2) factors in productivity improvements for non-fuel O&M expenses, which he believes will be motivated by a competitive market; (3) assumes extension of plant lives rather than retirement as projected by the Company; (4) removes fossil decommissioning costs; (5) incorporates Mr. Catlin's estimates of nuclear decommissioning costs in place of the Company's estimates; (6) recognizes working capital as an ongoing cash cost; (7) provides an alternative estimate reflecting savings in generation costs resulting from Duquesne's proposed merger with APS. OCA St. 1 at 20-21. Mr. Kahal also makes certain consistency adjustments in his analysis to reflect OCA witness Doug Smith's inflation rate and fuel costs. Id. at 21.

As reflected in the Company's Rebuttal Filing and Table 1, the Company has estimated owned-generation stranded costs of $1.542 billion as of 1/1/99. DLC Exh. DJC-10 and Table 1. In contrast, OCA has estimated owned-generation stranded costs of $1.020 billion on a stand-alone basis, as reflected on Table 1.

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[3]While the Company's presentation in Exhibit DJC-10 does bring the Company's stranded cost valuation forward to 1999, a number of significant differences remain between the way that exhibit is calculated and the way OCA's numbers are calculated. In particular, Exhibit DJC-10 states numbers on a net of tax basis while OCA's numbers are pre-tax. Further, regulatory assets in Exhibit DJC-10 are not all stated on a Net Present Value basis. These problems are eliminated in the schedules attached to this Brief, which do provide an apples-to-apples comparison of Duquesne's and OCA final positions, on a net of tax basis.

The Company's estimate reflects a market value of only $27 million for its assets which contrasts with OCA's estimate of $299 million. The Company's analysis reflects $57 million of unfunded nuclear decommissioning costs, while OCA's reflects $44 million. The Company's analysis in rebuttal also reflected a new claim for $208 million in costs (primarily Administrative & General costs that have been allocated to generation) that the Company claims could not be avoided by the shutdown of its uneconomic plants. The following table presents a summary of the Company's claim as compared to OCA's proposed owned-generation stranded cost value on a net of tax basis:

	Duquesne Light Company ($ Millions)	Office of Consumer Advocate ($ Millions)
Net Book Value	$ 917.61	$ 913.02
Working Capital	0.00	61.53
M&S and Fuel-Related Sunk Costs	41.11	0.00
PV of BV2 Lease Expense	278.24	300.35[4]
PV of Decommissioning	123.90	44.47
PV of Costs Independent of Operation	208.23	0.00
Estimated Market Value	(27.40)	(299.07)
Stranded Owned-Generation Costs	1,541.69	1,020.31

As shown by this Table, the Company's owned-generation stranded cost estimate exceeds OCA's estimate by $521.38 million. Each component of this difference is discussed individually below. However, it is important to emphasize what is indicated by the Company's results. Both the

[4]The amount shown in this table, as reflected on Exhibit DJC-10, is the net of tax amount of the lease expense, which is shown here for purposes of consistency. However, stranded costs reflected in OCA's schedules appropriately gross-up for taxes the Company's regulatory assets and the lease expense associated with Beaver Valley 2, and, therefore, are higher than these amounts and can be utilized, without further adjustment, to develop the CTC. In order to collect the stranded costs reflected on DJC-10, the Company would similarly have to gross-up such amounts for taxes. However, this schedule and Table 1 accurately reflect the dollar difference in positions between Duquesne and OCA.

Company and OCA agree that Duquesne has substantial stranded costs. In fact, Duquesne estimates that its stranded costs exceed the combined net book value of its plants and present value of its Beaver Valley 2 lease expense. DLC Exh. DJC-10. The implication of Duquesne's analysis is that, as OCA witness Kahal testified, Duquesne "would have to pay a buyer over $200 million to take the assets, even if Duquesne retained the nuclear decommissioning obligation." OCA St. 1-S at 10.

OCA witness Kahal explained the primary reasons for this difference in his Surrebuttal Testimony:

> There appear to be two main reasons. First, Mr. Clayton's analysis produces very little net operating revenue, i.e., only $27 million life time net present value for all units combined. By comparison, my analysis obtains approximately $300 million of net revenues, which I believe is a very modest result. Second, Mr. Clayton's study introduces for the first time the concept of operating losses as a separate stranded cost component. This comes to over $200 million in Mr. Clayton's study.

OCA St. 1-S at 10-11.

As indicated above, in addition to issues surrounding the quantification of owned-generation stranded costs, the second issue is the recoverability of such costs. The Company has claimed that it is entitled to recover such costs, with a full return, during the CTC recovery period in this case. As discussed below, it is OCA's position that owned-generation stranded costs should be amortized over the CTC recovery period and the Company should not be permitted to recover carrying costs (a return) on the unamortized balance, consistent with the Commission's treatment of uneconomic costs in other contexts.

2. Net Book Value

a. Total Net Book Value

As estimated by OCA, Total Net Book Value of the Company's owned generation assets, is $913.02 million excluding Beaver Valley 2 lease costs and $1,274.91 including those costs (net of tax). As discussed below, Beaver Valley 2 lease costs are properly characterized as owned-generation assets and recovered pursuant to Section 2808(c)(3). OCA's Net Book Value also

reflects an adjustment to remove $5 million associated with Brunot Island, which represents the amount from the Ft. Martin sale proceeds which was to be used to restore those plants to service. Since those plants are not being returned to service, this amount should be used as a reduction to the value of that plant.

b. Treatment of Beaver Valley 2 Lease Costs

Because the level of recovery under Section 2808(c)(3) is a discretionary determination and recovery under Section 2808(c)(1) and (c)(2) are not discretionary as noted above, characterization of the Company's claims may make a difference in the final stranded cost recovery allowance. One item about which OCA and the Company disagree is the treatment of the Beaver Valley 2 nuclear generating station. Duquesne proposes to treat only $32.48 million associated with Beaver Valley 2 as an "owned-generation" asset and proposes to treat the lease payments as regulatory assets subject to recovery under Section 2808(c)(1). OCA submits that the entire amount of the Beaver Valley 2 lease should be classified as owned-generation and subject to Section 2808(c)(3) since, as explained by OCA witness Kahal, the sale leaseback transaction is merely a "financing vehicle" and Beaver Valley 2 is, in reality, "owned" by Duquesne.

In its Rebuttal Testimony, the Company does not appear to object to reclassification of these costs as owned-generation, but notes that this does not change the Company's claim. DLC St. 2-R at 18. While OCA agrees that this does not change the Company's claim, reclassification of these assets to Section 2808(c)(3) gives the Commission discretion in providing for recovery of such costs. Consequently, the Beaver Valley 2 lease costs should appropriately be reclassified as owned-generation.

c. Recovery of Phillips and Brunot Island Costs: $5 Million of the Company's Investment in Brunot Island Should Be Removed From Net Book Value To Reflect The Company's Commitment To Utilize $5 Million From The Ft. Martin Sale To Refurbish Those Units.

As reflected above, the Company's and OCA's Net Book Value differ by only $5 million. This difference reflects OCA witness Kahal's adjustment with respect to treatment of Brunot Island Units

2B and 3, which are currently in cold reserve. OCA St. 1 at 23. As Mr. Kahal testified, $5 million of the Ft. Martin settlement was to be used to reduce the costs of returning those units to service. Id. Since it now appears that those units will not be returned to service, the unrecovered net investment in the units should be reduced by this amount. Id. Consequently, OCA's Net Book Value reflects this reduction.

In his Rebuttal Testimony, OCA witness Clayton contends that OCA's interpretation of the Ft. Martin settlement is "novel" and is not supported by the agreement, and that the Company did not agree to credit $5 million without recovery of, or return on, such investment. DLC St. 1-R at 35.

OCA submits that it is Duquesne's reading of the Ft. Martin agreement that is novel. The Company's Declaratory Order Petition in this case clearly spelled out that it would "use the proceeds" from the Ft. Martin transaction "to rehabilitate and restore to service the simple cycle units located at the Company's Brunot Island Power Station." In Re: Petition of Duquesne Light Co. for a Declaratory Order, P-00951001, Petition at 4 [hereinafter Ft. Martin Petition]. There is no language in the Petition that indicates any source of funding other than the proceeds of this transaction to fund such costs. Certainly, if such costs were intended to be subsequently included in rates, then the Petition would have made clear that the proceeds of Ft. Martin were being utilized only as an interim funding mechanism. In this regard, the Petition clearly did not provide any quid pro quo that the Company would recover such investment, and a return on such, from ratepayers. To the contrary, the Petition specifically spelled out that Duquesne's rates could not increase through the year 2000. Among other things, the Petition further provided for a one-time reduction in the Company's nuclear plant investment of $130 million; accelerated depreciation and amortization of nuclear plant investment of $25 million in each year 1996-1998; a $5 million increase in Duquesne's contribution to its nuclear plant decommissioning fund without any increase in existing rates; an annual $5 million credit to the ECR to compensate for reduced off-system sales resulting from the Ft. Martin sales. None of these financial commitments were made contingent upon subsequent compensation by ratepayers. Likewise, the use of Ft. Martin proceeds to restore Brunot Island was not contingent

upon subsequent ratepayer financing of this investment. The Commission's approval of the Petition was clearly made with the understanding that at least $5 million of this restoration project would be funded solely with Ft. Martin proceeds and there is no basis to suggest that ratepayers should now pay these costs. Ft. Martin Petition, slip op. at 3 (June 20, 1996). Consequently, OCA's adjustment to remove these costs should be adopted.

d. Conclusion

Thus, total net book value at 1/1/99 will be $1,212.96 million, reflecting treatment of all Beaver Valley 2 lease payments as owned-generation and removal of $5 million from Brunot Island, consistent with the Company's commitment in the Ft. Martin sale.

3. Market Value

a. Introduction

As indicated above, the determination of the market value of the Company's generating facilities, in the absence of a sale of those facilities, involves an estimation of the net present value of the net margins to be generated by those facilities. As indicated above, the Company and OCA both utilized a net margin analysis to determine the market value of Duquesne's generating facilities. The difference in results -- $272 million -- produced by those analyses are primarily attributable to two factors: (1) different market price projections and (2) assumptions regarding treatment of generating facilities at the end of their useful lives (life extension).

OCA's approach to valuing owned-generation stranded costs was specifically endorsed by the Commission in the PECO Order, slip op. at 90, finding that OCA witness' approach "best balances all of our considerations." In particular, the Commission found OCA witness Smith's analysis of market value the most credible, convincing, and reasonable and was truly an "objective" analysis as compared to the other market value witnesses in the case:

> Though there is no single proposal that we find completely convincing on every component of its analysis, we adopt the testimony of OCA witness Smith as the most reasonable determination of future market value in the record and therefore determine a market value of PECO's stranded generation plants of $3.96 billion as of 12/31/98. Witness Smith's testimony is the most credible, and least criticized of

> any of the other market value witnesses, and produces a result approximately midway between the other two most credible models. We are also convinced that witness Smith performed an objective analysis of the issues in this proceeding, a task that the Commission believes no other party truly performed.

PECO Order, slip op. at 88.

The Commission also concluded that the ENPRO model used by Mr. Smith "fairly represents several other important matters such as unit commitment, NUG operations, fuel prices, imports and exports, and heat rates." Id. at 89. The Commission also noted its specific agreement with Mr. Smith's "approach to fuel use by dual fuel units, the cost of new generation, and the use of average heat rates." Id. at 90.

Before addressing the specific details of Mr. Smith's market value analysis in this case, OCA would emphasize that Mr. Smith's analysis, after adjusting the model to reflect the market area served by Duquesne and the data available for that market area, is, for all practical purposes, the same as the model utilized in the PECO case. In light of the Commission's findings as to the credibility and reasonableness of Mr. Smith's analysis and to be consistent with the approach taken in PECO, OCA submits that the Commission should adopt OCA's analysis of the market value of owned-generation assets in this case. As discussed below, the result produced by this analysis -- market value of $299 million compared to adjusted book value of nearly $1.5 billion -- is consistent with what one would expect for Duquesne's mix of resources. In particular, the evidence shows that Duquesne's stranded costs are driven almost entirely by its high cost nuclear operations. Duquesne's coal plants, on the other hand, are generally economic, consistent with the market evidence, such as the Ft. Martin sale, which shows market values of coal plants to be well in excess of book value. OCA St. 1-S at 11.

Consistent with its final valuation proposal, Duquesne, in its direct case, presented an analysis of the market value of its generating assets at January 1, 2006 and compared that projected market value to its projected net book value at that date, net of committed generation related depreciation and amortization, to determine that stranded costs of between $8 million and $513

million would still exist at that date. Projected market values were based on an analysis of market prices prepared by Duquesne witness Michael M. Schnitzer and on forecasts of production costs and generation output by unit provided by Duquesne witness Mark Karl. This analysis was brought forward to January 1, 1999 in the Company's Rebuttal case, which reflects a market value as of that date of $27.04 million, based on Mr. Schnitzer's "low" estimate of market value. DLC Exh. DJC-10. The Company's high estimate of market value is $278 million. DLC Exh. DJC-20, p. 1.

OCA submits that the Company's low market value estimate, based on Mr. Schnitzer's projection of the price of new capacity in 2006, is unreasonably low and fails to reflect the likelihood of life extension of existing units. In its place, the Commission should adopt OCA's estimate of market value of $299 million, which reflects the results of Mr. Smith's dispatch simulation model for the APS/DQL area and Mr. Kahal's adjustment to life extend the Company's units. Notably, this estimate is not significantly higher than Mr. Schnitzer's high market value estimate, which does not take life extension into consideration.

b. Market Price Projections

i. Forecasting Methodologies

(a) Duquesne's Approach

As discussed above, the Company developed projected market values based on an analysis of market prices prepared by Michael M. Schnitzer, a consultant with the NorthBridge Group in Waltham, Massachusetts. For this purpose, Mr. Schnitzer developed "a range of ceiling market prices . . . based on the cost of new entry beyond 2005." DLC St. 3 at 25. In other words, rather than estimating market prices in 2006 and beyond per se, Mr. Schnitzer estimates the cost of entering the market by new construction in 2006 and this cost represents the "ceiling" on the market price. Id. It is Mr. Schnitzer's view that this approach is "conservative" and will tend to overstate market prices (and thus understate stranded costs) "because if market prices were to exceed the ceiling it would be economic for new entrants to contest the market at those prices." Id. at 25-26.

In performing his analysis, Mr. Schnitzer assumed that "the technology of choice for new

entrants in 2006 will be a gas-fired combined cycle unit" and developed a range of prices reflecting alternate assumptions concerning capital cost, heat rate and the capital structure and payback requirements of the project. Id. at 26. The details of these alternate assumptions are set forth in Exhibit MMS-2. In order to determine market prices for new gas-fired CC entrants, Mr. Schnitzer also estimated gas prices delivered into ECAR. Id. at 26-27.

Using this approach, Mr. Schnitzer estimated market prices in 2006 ranging from $34/MWH to $44/MWH in 2006 dollars, and escalated these prices with an annual estimate of general inflation of 2.5%. Id. at 27. Further, these prices were presented as "a real levelized price" reflecting an 84% capacity factor which reflects the average capacity factor of Duquesne's generation portfolio. Id. Mr. Schnitzer testified that, in his view, prices are likely to be lower than this range due to improvements in technology, customer demand response (i.e. customer willingness to interrupt), less costly supply options than included in his projections, and excess entry into the competitive market. Id. at 30-31. Additionally, Mr. Schnitzer pointed to Duquesne's RFP to support his view that the Company's low market prices are more realistic. Id. at 32-37.

In his Rebuttal Testimony, Company witness Clayton calculated stranded costs as of December 31, 1998 in Exhibit DJC-20 based on Mr. Schnitzer's low market scenario, since the Company believes it is this scenario that is "most likely to occur." DLC St. 2-R at 12. This analysis produces stranded costs of $1.916 billion as shown on Exhibits DJC-10 and DJC-20.

(b) OCA's Approach

In contrast to Duquesne witness Schnitzer's analysis of the cost of entry as the upper bound of a range of market value, OCA witness Douglas C. Smith presented a dispatch simulation model of the APS/DQL system as a single market area using the ENPRO dispatch simulation model to estimate market revenues in each hour. OCA St. 2 at 5. ENPRO is a detailed, chronologic model used by utilities and others for a range of operational and planning analysis, and is well suited for the purpose of estimating market prices based on the dispatch of marginal units for a large electric system. Id. In its PECO Order, the Commission specifically approved the ENPRO model as quite

suitable to the task of estimating generating market revenues. PECO Order, slip op. at 89.

ENPRO incorporates a number of key inputs into the model itself, while other inputs were determined by Mr. Smith. In particular, ENPRO represents unplanned (or "forced") outages of generating capacity randomly on a daily basis, and planned outages are scheduled to the extent possible during offpeak periods. Id. Imports are represented explicitly as available sources to be dispatched when economic. Id.

Mr. Smith represented the energy market in terms of bids for delivered energy from each generating unit, with each bidder assumed to bid a price sufficient to recover its average variable cost based on the unit's historical as-operated heat rate. Id. Like Mr. Schnitzer, Mr. Smith also assumed that, over time, market prices must be sufficient to support the cost of new market entrants. Id. For this purpose, he assumed that newly constructed Combustion Turbine (CT) units would be used for peaking duty and Combined Cycle (CC) units would be used for baseload/intermediate duty. Id. Mr. Smith assumed all-in capital costs of $560/kW in 1997 dollars for the CC option and $296/kW in 1997 dollars for the CT option, based on a review of industry data and estimates provided by other Pennsylvania utilities. Id. at 9. These estimates are derived on Mr. Smith's Exhibits DCS-2A (CC) and DCS-2B (CT). Id. Mr. Smith views these as conservatively low estimates of the costs associated with new entrants for a number of reasons, including (1) his expectation of greater interest costs during construction, (2) increases in CC/CT equipment costs from current market conditions which represent historical lows for such costs; (3) higher land costs as compared to the generic land prices used by Mr. Smith, (4) higher project development costs ("soft costs"); (5) higher plant costs associated with selection of other than "plain vanilla" plant equipment and services, reflecting choices of units with more efficient steam cycles, reliability features such as a bypass stack or multiple shaft design, more extensive site work and buildings and large inventories of spares; (6) higher costs associated with selective catalytic reduction equipment; and (7) the inclusion of general plant (not included in his estimate) which would presumably be incurred by generating companies in the ECAR market. Id. at 9-10.

The costs of new entrants were factored into Mr. Smith's dispatch model through the use of an annual fixed charge, or carrying charge rate, which reflects the capital-related costs of the unit as a percent of the project's initial cost. Id. For this purpose, he utilized a 12.75% carrying charge rate. Id. at 10-11.

Mr. Smith's analysis assumes that all generators selling into the spot market at any given time will receive the same price for their output and that price will reflect the highest bid accepted by the system operator, and that bidders will bid hourly output based only on its variable cost. Id. at 11. Thus, generating units with high variable costs that run infrequently would receive little or no contribution toward their fixed costs in most hours. Id. However, such units would need to recover such costs and Mr. Smith indicates that the market will provide mechanisms to enable the recovery of such costs. Id. at 11-12. He identified four ways in which the market would compensate for these costs: (1) bids above variable costs; (2) interruptible demand payments; (3) bilateral transactions; and (4) ancillary service revenues. Id. at 12-13.

Mr. Smith expects that a combination of these mechanisms will yield market prices sufficient to support the level of system reliability that customers desire, or that is established through minimum capacity requirements. Id. at 13. Thus, as Mr. Smith explained, "generation market prices will most likely exceed the variable cost of the highest-cost generating unit(s) in the market during some fraction of the year," resulting in what he has termed "reliability-related" revenues. Id. Mr. Smith assumes in his analysis that, in the long run, such revenues are capped at the estimated cost of peaking capacity, i.e. "the real-levelized cost of a newly constructed combustion turbine." Id. He further assumed that these revenues would be concentrated in "only the highest-demand hours, so that all generating units would receive the same reliability-related revenues on a per-kW basis" and that sufficient generating capacity would be constructed to maintain an eight percent reserve margin of installed capacity, above the annual peak demand. Id.

Mr. Smith explained that actual market prices could turn out to be higher because upward pressure may be exerted on prices in the Northeast and Mid-Atlantic because of the earlier need for

capacity in the PJM market and retirements and unavailability in the NEPOOL market area. Id. at 14. Upward pressure resulting from the retirement of units for economic reasons may also drive prices higher than assumed by Mr. Smith, who did not test the economic viability of ECAR generating units, but rather conservatively assumed that existing units would continue to operate.

(c) OCA Witness Smith's Forecasting Methodology Is A Sound Approach To Market Price Estimation.

What should be clear from the preceding discussion is that, in comparison to Duquesne witness Schnitzer's analysis, OCA witness Smith's forecasting methodology provides a more robust analysis of the interactions between supply and demand in the marketplace than that presented by Duquesne in this proceeding.

ii. Input Assumptions

a. Introduction

As indicated above, in its PECO Order, the Commission commented specifically on the objectivity of OCA witness Smith's analysis. PECO Order at 88. The Commission commented in particular on Mr. Smith's methods and assumptions, noting the following approach described in his testimony:

> My analysis is intended to assist the Commission by providing a balanced, non-utility perspective on generation market issues. My general approach in developing assumptions and methods used in the analysis was not, however, to develop a high bound or "counter" to the Company's analysis. As shown in my discussion of the costs and carrying charges associated with new generating units, I have sought a reasonable expected value outcome on each issue. I believe that I have chosen assumptions that have equal likelihood of being above or below the actual outcome.

PECO Order, slip op. at 88; see also OCA St. 2 at 2-3 (in this case). The Commission specifically concluded that Mr. Smith's objectivity was evidenced by his not adjusting "PECO's treatment of nuclear capacity factors and reserve requirements in a way that increases stranded cost recovery . . . even though adjustments would have reduced PECO's stranded cost recovery significantly and would have been consistent with his credible testimony in the May 22, 1997 QRO proceeding. Id.

A number of the input assumptions utilized by Company witness Schnitzer and OCA witness

Smith in the present case have been discussed above in connection with their forecasting methodologies. Because Mr. Schnitzer does not use a dispatch simulation model, his input assumptions -- primarily his estimated cost of new capacity -- are very limited and in large part have been discussed above. OCA will, therefore, just briefly summarize Mr. Smith's other input assumptions and rebut the Company's criticisms of them.

As noted above, in its PECO Order, the Commission specifically indicated its agreement with Mr. Smith's assumptions regarding fuel price and the cost of new generation capacity. PECO Order, slip op. at 89-90. The Commission also agreed with Mr. Smith's assumptions regarding unit commitment, NUG operations, fuel prices, imports and exports, fuel use by dual fuel units, and the use of average heat rates. Id. Mr. Smith's primary input assumptions which are, for all practical purposes the same as he used in PECO, are set forth on pages 14-16 of his Direct Testimony and include the following:

- Fuel Price Estimates: Mr. Smith's fuel price estimates were based on actual annual fuel prices on a station basis for calendar year 1996, from FERC Form 423 and escalated, for most units, based on escalation rates from DRI's Spring 1997 price forecast, the same fuel forecast used in PECO, as shown on Exhibit DCS-3. Base fuel prices at certain units were adjusted from 1996 levels to reflect the anticipated expiration of above-market coal supply contracts. The base prices assumed for Hatfield Ferry and Mitchell are those asssumed by West Penn in its restructuring case and base prices for Bruce Mansfield and Elrama are based on Duquesne witness Karl's assumptions. Fuel prices at Hatfield Ferry, Harrison and Pleasants were adjusted from year 2003 forward to reflect the planned utilization of gas reburn to control NO_x emissions.

- Environmental/Emission Adders: Mr. Smith's environmental adders for SO_2 and NO_x allowances are based on actual emissions rate multiplied by the emission allowance prices forecasted by APS, and netted against West Penn's EPA allowances, with an adjustment to take account of more stringent regulations taking effect in 2003.

- Variable O&M Costs: Mr. Smith's variable O&M costs for existing generating units are based on assumptions presented by PECO in Docket R-00973877.

- Heat Rates: Mr. Smith used as-operated heat rates for 1996, as obtained from FERC Form 1.

- Unit Commitment: Mr. Smith's generating unit availabilities/commitments were developed from major classes of generating units, based on NERC records of 1990-1994 actual generating unit availabilities except that the output of the Lake Lynn hydro station was based on the annual output assumed by West Penn in its restructuring case and the Perry and Beaver Valley nuclear generating stations were assumed to produce at a 75 percent annual

capacity factor.

- NUG Capacity: Mr. Smith projected non-utility generating capacity in accordance with the NERC 1996 Electric Supply and Demand Database, and NUG unit cost and energy production assumptions were developed from FERC Form 1.

- Peak and Annual Requirements and Load Shape: Projected peak load and energy requirements were based on the 1996 NERC Electricity Supply and Demand database and the hourly load shape was based on an average of the 1995 and 1996 actual hourly shapes.

b. Capacity Reserve Margins

In his Rebuttal Testimony, Company witness Karl criticized a number of the assumptions used by OCA witness Smith in his analysis. First, Mr. Karl criticized Mr. Smith's use of an 8 percent capacity reserve margin, implying that Mr. Smith inappropriately uses this value as an administratively determined capacity requirement for ECAR. DLC St. 9-R at 2. However, as explained by Mr. Smith, his analysis is not based the assumption of an administratively determined capacity payment; rather Mr. Smith assumes that customers will seek a level of system reliability comparable to historical minimum targets, which have been estimated to require approximately an eight percent regional installed capacity reserve margin. OCA St. 2-S at 2-3. OCA submits that it is reasonable to use this approach in the context of forecasting generation market prices. Indeed, the Commission specifically endorsed Mr. Smith's capacity assumptions in its PECO Order.

c. Generating Unit Availability/Commitment Assumptions

Company witness Karl also raised questions regarding the generating unit availability assumptions utilized by Mr. Smith, which is based on historical availability records for major classes of generating units, as assembled by the North American Electric Reliability Council ("NERC"). Mr. Karl claims that this data is problematic because it does not represent unique units/plants. However, as Mr. Smith explained, the future availability of generating units is uncertain and even unit-specific availability records provide no guarantee of future performance. OCA St. 2-S at 3. Furthermore, small variations in availability for particular generating units would have only a limited effect on market prices in a system such as the APS/DQL system modeled in Mr. Smith's analysis. Id. Thus, Mr. Smith concluded that it is not an important limitation of the analysis. Again, the Commission

found Mr. Smith's unit commitment assumptions to be reasonable in its PECO Order, slip op. at 89.

d. System Load Shapes

In his analysis, OCA witness Smith assumed that annual peak demands and energy requirements in the APS/DQL area will increase as projected for ECAR in the 1996 NERC Electricity Supply and Demand Database, and he developed an hourly load shape based on an average of the 1995 and 1996 actual hourly shapes. OCA St. 2-S at 4.

Mr. Karl criticized this input, contending that development of a combined load shape requires an assessment of the individual customer classes for APS and DQL. DLC St. 9-R at 7. As Mr. Smith explained, however, this is not the case for the base year which simply represent the sum of the hourly loads of the two systems. OCA St. 2-S at 4. While the hourly load shape in future years is uncertain, the relatively stable nature of installed loads and usage patterns make the historical curve the best basis from which to forecast. Id. Mr. Smith explained further that short term trends in load shape will likely have only a secondary effect on market prices and other factors such as the overall magnitude of demand growth, fossil fuel prices and the cost of new market entrants will likely be more important. Id. In the long term, it is reasonable to expect that changes in the system load shape will be partially or entirely offset by changes in the generation mix, with the amounts and type of new market entrants developed to "fit" the actual load shape and market price signals. Id.

e. Generating Unit Heat Rates.

While Mr. Karl does not raise a fundamental disagreement with Mr. Smith's use of as-operated heat rates, he points out that changes in a generating unit's operating role over time could alter the unit's as-operated efficiency and heatrate. DLC St. 9-R at 9-10. As Mr. Smith explained, however, units that are called upon to operate in the same manner as they were in the past, but are simply called upon to do so more often, are unlikely to experience material changes in their as-operated heat rates. Mr. Smith's assumptions are reasonable and appropriate.

f. Fuel Price Assumptions

With respect to fuel price assumptions, Company witness Karl raises a general concern with

respect to natural gas price forecasts, based on Duquesne's experience that such forecasts have overstated actual market prices in the past. DLC St. 9-R at 11. While future fossil fuel prices are plainly uncertain, this does not mean that fuel price forecasts are not appropriate for estimating future prices. OCA St. 2-S at 5-6. The DRI forecast which Mr. Smith utilized is widely accepted and was effectively adopted by the Commission in the PECO case. The Commission should use a consistent forecast in this case.

iii. Results

It is important to emphasize that the results of the analysis presented by the Company in this case and that of OCA do not differ dramatically. In particular, Mr. Schnitzer's new entry prices produce a range of market values of Duquesne's generating assets from $27 million at the low end to $278 million at the high end, and $159 million based on a delayed entry. Exh. DJC-20, p. 1. OCA witness Smith's market price projection, as adjusted to include Mr. Kahal's adjustments for productivity and life extensions, produce $299 million of market revenues, at 1/1/99. OCA St. 1-S, Sch. MIK-1 (12/97 Update), p. 2; Table 1.

c. Other Evidence of Market Value

As pointed out by Mr. Kahal in his Surrebuttal Testimony, Duquesne witness Clayton's estimate of a market value of $27 million for its plants, excluding consideration of decommissioning costs is inconsistent with other market evidence. OCA St. 1-S at 11. In particular, Mr. Kahal pointed to Duquesne's sales last year of its 50 percent ownership in the Ft. Martin 1 coal unit for $169 million, as about six times its estimate of value for all of its units combined. Id. Indeed, if one were to accept Duquesne's stranded cost calculation, it would make sense for the Company to give away the plants when one considers decommissioning liabilities. Id. at 10. The Company's forecast is below a reasonable expectation of market value for these units and should be rejected in favor of Mr. Smith's market valuation.

d. Conclusion

In light of the above, OCA submits that Mr. Smith's market price projections and the resulting

market revenue is reasonable and is supported by the evidence.

4. Other Factors Affecting Market Value/Stranded Costs

a. Life Extension

The Company calculates market revenues realized over the book lives of its generating units. As Mr. Kahal notes, for the Company's major coal-fired generating plants, this assumes a "useful life of approximately 40 years." OCA St. 1 at 34. In part, this is because Duquesne believes that addressing life extension at this time would be premature and Duquesne would reserve judgment on this issue until its proposed "final valuation" in 2003. Id. at 35. For this reason, Duquesne was unable to provide any studies regarding life extending its generating units, but has indicated that they would be prepared and made available for the 2003 valuation. Id.

OCA witness Kahal testified that while the Company's failure to perform life extension studies is "understandable if the purpose is merely one of reporting an integrated resource plan," its position is not reasonable in the context of a stranded cost study intended to provide the basis for competitive transition charges. Id. at 36. As Mr. Kahal stated, the Company's study must incorporate all reasonable mitigation measures to reduce costs or enhance the plant revenue stream. Id. Furthermore, while new environmental regulations may affect the attractiveness of life extension, it is one-sided to arbitrarily assume that these requirements would prevent life extension for every unit. Id. Instead, since it is common to maintain major coal-fired units in operation beyond their 40-year book lives, it is necessary and appropriate to take into consideration life extension of units as a means of mitigating stranded costs. As Mr. Kahal testified:

> The Company's position is not reasonable in the context of a stranded cost study intended to provide the basis for customer transition charges. Such a study must incorporate all reasonable mitigation measures to reduce costs or enhance the plant revenue stream, and life extension is a potential mitigation which Duquesne should consider.

Id.

Moreover, even were the Commission to accept Duquesne's final valuation approach, as Mr. Kahal pointed out, life extension benefits must be considered at this time because Duquesne's

stranded cost analysis is intended as a "test" of Duquesne's seven-year rate cap plan. Id. Ignoring the likelihood of life extension means that this test is biased and distorted. Id. OCA would emphasize that PECO Energy included life extension for three coal plants in its stranded cost analysis. Id. at 35, 37. These life extensions were incorporated in the OCA analysis in PECO, which was adopted by the Commission.

Because Duquesne has done no study, detailed estimates for life extending Duquesne's coal plants are not available. In the absence of this information, OCA witness Kahal used information from the PECO case and the West Penn case (Schedule MIK-7) to determine that a reasonable estimate for the cost of life extending a coal-fired power plant is approximately $200 per kW in 1997 dollars. Id. at 37. Mr. Kahal utilized this figure as a "base case" cost; however, in light of environmental uncertainties and the possibility of other unknown costs, Mr. Kahal also considered a capital cost of $300 per kW in 1997 dollars. Id.

Schedule MIK-8 provides Mr. Kahal's screening study for each Duquesne coal unit, which include Sammis, Cheswick, Eastlake, and each of the three Mansfield units. This study shows the life extension benefits for an assumed 15-year extension, based on OCA witness Smith's market price projections, fuel costs and non-fuel O&M costs and Mr. Kahal's estimate of life extension costs. Id. Life extension is shown to be cost-effective for all units at a capital cost of $200 per kW but cost ineffective for Eastlake and Mansfield 1 at $300 per kW. Id. Using thse figures, Mr. Kahal determined a reasonable range of life extension net benefits to be $171 million to $210 million, present valued at 1/1/99, and, to be conservative, he utilized the lower end net benefit as his adjustment to Duquesne' stranded cost. Id.

The Company did not present specific rebuttal to Mr. Kahal's testimony with respect to life extension. OCA submits that Mr. Kahal's adjustment to reflect economic life extension of units in the amount of $170.72 million, is appropriate and should be adopted.

b. Plant Shutdowns

In its Direct case, the Company set the market value of generating facilities to $0 (excluding

decommissioning) if the plant could not provide any net operating margins over the life of the plant. DLC Exh. DJC-3, p. 44; see OCA St. 1-S at 11. Consistent with this approach, OCA witness Kahal's stranded cost analysis produces a $0 market value for all of the Company's nuclear plants and several of the coal plants. OCA St. 1 at 24 & Sch. MIK-1, p. 2. Additionally, for one coal plant -- Cheswick -- Mr. Kahal initially determined that it would be most economic if the plant were temporarily shutdown and then restarted. Id. at 24-25. Mr. Kahal explained the reasons for assuming a zero dollar value for these units:

> A negative net present value result must be treated as zero, since to do otherwise would assume a negative market value for the unit. A negative result, however, does not necessarily mean that the plant should be retired. It may be economical to continue to operate the plant if operating expenses can be reduced and/or if the plant can operate at higher output levels than included in Mr. Smith's analysis. Moreover, if projected early year losses are substantial but later year margins are positive, it may make sense to temporarily shut down the plant and restart it when market conditions warrant a few years hence. This might be an effective mitigation strategy.

Id. For purposes of determining costs that would be "stranded" as of 1/1/99, it makes no sense to include future operating losses that have not been incurred and indeed will not be incurred in any reasonable economic scenario.

In its Rebuttal Testimony, the Company modified its analysis, indicating that the economics of retiring units is a complicated issue and proposing to submit a detailed study on, or before, January 1, 1999. DLC St. 1-R at 24. The Company contends that, when "unavoidable costs" are considered, Perry, Beaver Valley Unit No. 2 and Cheswick should not be shut down at this time. DLC St. 2-R at 37.[5] The Company's analysis shows, however, that after consideration of "unavoidable costs," the Elrama unit is not economic. Id. While Elrama produces net *negative* margins after consideration of all costs, Duquesne contends that the impact of closing Elrama on the transmission system must be considered. Id. at 37-38.

While OCA is not recommending the retirement of any generating units, especially in the

[5] To reflect these "unavoidable costs," which are, in general, allocated A&G costs which the Company claims could not be reduced, the Company has made a new claim for "Costs Independent of Operation," which are discussed below.

absence of an analysis of the economics of doing so, Duquesne's failure to address these operating losses prior to its Rebuttal case and its failure to study its ability to reduce or avoid these operating losses, is problematic in evaluating the Company's stranded cost claim and its rate cap plan. OCA St. 1-S at 6-8. As OCA witness Kahal explained:

> Aside from the October update revisions to cost data, the existence of these operating losses and the economic viability of its generating units was known to Duquesne well before it filed its case on August 1, 1997. Duquesne made a conscious and deliberate decision not to address this problem and not to reveal the operating losses, instead burying the losses within its financial projections.
>
> After the issue of unnecessary operating losses was raised by the OCA (and others), Duquesne then proceeded to introduce in rebuttal cost data indicating that some of the operating losses may be unavoidable when there is no realistic opportunity to analyze and study those data. Moreover, conceding that some of the losses may be avoidable, Duquesne agrees to study the issue after this proceeding is over. Since avoidance of operating losses is an issue of mitigation, I believe that Duquesne has an obligation to address the issue in this proceeding, not study it at some future time. The lack of clear evidence on this issue is one reason why the rate cap plan cannot be accepted.

Id. at 8. OCA submits its approach of setting the plant margins of these units to $0 (excluding decommissioning) is reasonable and should be adopted. The Company's specific claims regarding its "unavoidable costs" of operating these units will be discussed below. However, in order to reduce controversy and to recognize that there would be shutdown and restart costs (and ongoing caretaker costs) associated with the Cheswick plant if it were to be temporarily shut down, Mr. Kahal *modified* his position to assume continued operation of that unit with losses, rather than temporary shutdown. OCA St. 1-S at 13-14. Since life extension of that unit still produces overall plant margin, operations at the plant should be maintained for purposes of calculating stranded costs.

c. Productivity Gains

In developing the market value of generating units, Duquesne developed budget figures for non-fuel O&M expense for the transition period and escalated those at Company's assumed rate of inflation of 2.5% thereafter. OCA St. 1 at 33. The Company also took its A&G costs assigned to generating units and merely escalated them at its general inflation rate of 2.5%. Id.

While OCA agrees with the Company that escalation of these costs is appropriate, OCA

witness Kahal testified that the transition to a competitive environment will also result in productivity gains, reducing both the Company's non-fuel O&M and its A&G costs. As Mr. Kahal explained, increases in productivity and efficiency are central to the move to competition:

> Certainly, one of the primary reasons of moving from a system of regulated monopoly, subject to cost-plus pricing, to competition is the belief that competition will motivate new efficiencies and cost control benefits not attainable under regulation. Moreover, such efficiencies are not merely a one-time or episodic effort at cost control (e.g., a utility downsizing initiative at a given point in time) but will be continual. Once deregulated, the owners of generation assets will be seeking ways of controlling costs and improving productivity on an ongoing basis.

OCA St. 1 at 29.

While the Company, in its budget figures, has reflected some efficiencies as a result of work force reductions until 2002, OCA witness Kahal testified that there should be some additional efficiency *gains after the* first few years of retail competition. Id. at 33. Mr. Kahal estimated a 1.0%per year gain in productivity beginning in 2003 and extending for ten years, with the savings capped at 10% and held constant over the remainder of the study period. Id. In support of this estimate, Mr. Kahal cited the analysis of the Staff of the Federal Energy Regulatory Commission ("FERC") which conducted an analysis of utility industry eefficiency gains resulting from the introduction of wholesale competition from transmission access. Id. at 33.[6]

In performing his analysis, Mr. Kahal applied this productivity adjustment to the Company's non-fuel O&M and A&G expenses for those plants with positive plant margins. Id. This analysis results in savings capped at approximately 10 percent in 2012, which are held constant over the

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[6] That study showed savings ranging from $3.8 to $5.4 billion per year, largely related to savings of fixed O&M at existing plants. Id. Additional cost savings are expected to come from improved unit heat rates and plant availability. Id. Overall, the FERC savings estimate equates to a 15 percent reduction in industry-wide (generation) fixed O&M costs. Id. The FERC suggests that an even higher level of savings, about 25 percent, should be considered. Id. Mr. Kahal also relied on a recent study conducted by the U.S. Department of Energy (DOE), which provides projections of the rate impacts associated with the introduction of retail access nationwide. That analysis assumed that non-fuel O&M costs for existing power plants would decline by 25 percent due to the onset of retail competition, with a "high efficiency" scenario inducing savings of 40%. Id. Mr. Kahal also noted that the Maine PUC, in 1995, approved an incentive regulation plan for Central Maine Power Company, which includes a price cap formula that assumes a 1.0 percent per year productivity gain.

remainder of the study period, as shown on Mr. Kahal's Schedule MIK-6.[7] Id. at 33-34 & Sch. MIK-6. The result of this adjustment is not a decrease in expenses, but an increase in such expenses of 1.0% less than the general inflation rate used in the analysis, or . Id. This results in an increase in plant margins at 1/1/99 of $13.04 million. OCA St. 1-S at 14 & Sch. MIK-6 (12/97 Update).

Clearly, the Commission's responsibility in this proceeding is to make a reasonable estimate of stranded costs. OCA submits that it would be unreasonable to assume that a competitive market does not produce gains in productivity since this would provide the benefits of normal productivity gains resulting from competition to shareholders while ratepayers paid exorbitant levels of stranded costs. OCA St. 1 at 30. As Mr. Kahal testified, his productivity adjustment is intended to capture only "normal efficiencies associated with moving from cost plus regulation to competition." Id. OCA agrees with Mr. Nelson that if the Company is able to exceed the competitive norm in terms of productivity, that it can and should reap the benefit of that performance. However, Mr. Kahal's modest productivity gain of 1% per year over a 10-year period, is a reasonable estimate of what the "competitive norm" would be, and should be reflected in determining stranded costs.

Mr. Nelson and Mr. Duckworth are also clearly in error in assuming that Duquesne's incorporation of historic mitigation efforts adequately addresses concerns about productivity gains. To the contrary, as Mr. Kahal explained, those efforts were made in the context of standard regulation and are a far cry from addressing the types of productivity enhancements that are likely to be realized in the context of a competitive market place. Id. at 31. Mr. Nelson's and Mr. Duckworth's assertions are clearly inconsistent with the *concept* of the developing competitive market and must be rejected and Mr. Kahal's adjustment adopted.

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[7]In his Rebuttal Testimony, Company witness Karl suggested that Mr. Kahal was attempting to impose a 40 percent reduction on these costs. DLC St. 9-R at 12. In his Surrebuttal Testimony, Mr. Kahal explained that this is not the case and that his analysis produces only "a very modest adjustment amounting to only 5 percent of projected fixed O&M and A&G costs" for the three plants for which he made adjustments. OCA St. 1-S at 14. As noted above, no adjustments were made for plants with negative margins, including all of the Company's nuclear plants. Id.

d. Costs Independent of Operation

As indicated in the discussion of plant shutdowns, the Company initially assumed that plants with a net negative plant margin at 1/1/2006 would have a zero dollar market value. In its Rebuttal Testimony, the Company modified this position, and in its analysis of stranded costs at 1/1/99, has included a claim of $208.23 million for "Costs Independent of Operation," which are essentially the net[8] "unavoidable costs" associated with the operation of plants that produce net negative margins in the Company's analysis. DLC St. 2-R at at 13-14 & Exh. DJC-10.

While Company witness Clayton appears to contend in his Rebuttal Testimony that it was not necessary to identify these costs in its direct case given the Company's final valuation proposal (DLC St. 2-R at 14), clearly the Company's failure to identify these losses/unavoidable costs as part of its Direct case has prevented other parties from assessing the validity of the Company's claim that such costs are unavoidable. OCA St. 1-S at 8. Moreover, Mr. Clayton's testimony indicates that while "many of these costs are not immediately avoidable" (DLC St. 2-R at 36-37), this does not mean that they may not be able to be avoided in the long run.

The Company's presentation on this entire issue is unjustified. Mr. O'Brien's Schedule MKO-2, as revised, presents the Company's estimate of avoidable overheads associated with its generating units. DLC St. 4-R, Exh. MKO-2. As indicated there, Mr. O'Brien has estimated that if Cheswick, Perry and Elrama were retired, only $2,752,000 out of $16,784,000 of overheads allocated to those plants could be avoided. Id. Thus, according to the Company, it would continue to incur overheads of over $14 million that had been allocated to these plants, even if they were retired. Id. This is only 16% of such costs ($2,752,000/$16,784,000).

In addition to these overheads, Mr. O'Brien provided Mr. Clayton with estimates of avoidable property taxes, capital stock taxes, and employee severances costs for Elrama and Cheswick. Mr.

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[8]These are "net" unavoidable costs because the Company's analysis indicates that for Perry, Beaver Valley 2, and Elrama, continued operation will produce plant margins which are sufficient to cover avoidable costs and provide some offset to these unavoidable costs.

Duckworth provided estimates of shut-down costs for Perry. Mr. Nelson provided estimated costs for placing Cheswick or Elrama in cold reserve and reactivating it, and for caretaker costs.

Mr. O'Brien's testimony shows that he considers approximately 16% of of overheads as avoidable but provides little explanation as to why he considers only this level of overheads from these plants to be avoidable.

To the best of OCA's knowledge, no other utility in Pennsylvania has presented a stranded cost claim for "Costs Independent of Operation." For the reasons set forth in Section IV(B)(4)(b), supra, OCA submits that they should not be allowed in this proceeding.

e. Projected Capital Additions and O&M Expense

With modifications only for Mr. Smith's higher inflation rate and fuel costs and for life extension, as discussed above, OCA witness Kahal has utilized the Company's projections of capital additions and O&M expense levels.

f. Environmental Regulations -- Discussed above in context of market prices

g. Other

i. Working Capital

The Company made no initial claim for working capital. OCA witness Kahal made an adjustment to increase stranded costs to reflect working capital of $45.62 million, net of an offset for the sale of inventory in the last year of each plant's life. OCA St. 1 at 27-28.

ii. Pilot Program Incentive Credits

If the Commission approves a reduction in rates as proposed by OCA, OCA submits that the pilot program incentive credits recognized as a stranded costs should be adjusted. OCA St. 1 at 16-17. Additionally, these should be adjusted to reflect the level and/or time of participation as compared to the forecasted level. Id.

iii. Half year Discounting for First Year of Analysis

While the Company applied a full-year of discounting to the first year, OCA witness Kahal

testified that only a half-year of discounting should be applied since it is more realistic to assume that Duquesne receives its cash flow evenly throughout the first year. OCA St. 1 at 25.

h. Conclusion

OCA submits that the market value of Duquesne's plants should be adjusted upward by to reflect increases for life extension and productivity enhancements and a decrease to reflect working capital requirements. Together with Mr. Smith's determination of market revenues before such adjustment, this produces $299 million in market revenues.

5. Conclusion

In light of the above discussion, OCA submits that the reasonable level of the Company's owned-generation stranded costs net present valued to 1/1/99 is $1.020 billion.

C. Merger Savings

The Company has indicated a willingness to reflect $160 million of additional accelerated depreciation if its merger with Allegheny Power System is consummated. DLC St. 1 at 37. However, the Company has not reflected merger savings in its computation of stranded costs, but has indicated, instead, that that issue be addressed in the context of the merger proceeding. The OCA disagrees. Because the outcome of the proposed merger will not be known until after the record in this proceeding is closed, it is improper to totally omit merger savings from the stranded cost study. Instead, the Commission should consider stranded costs both with and without merger savings. Id. at 39.

OCA witness Kahal estimated those savings using an analysis provided by Mr. O'Brien in the merger docket which shows year-by-year net merger savings. OCA St. 1 at 39. According to Mr. O'Brien's study, Duquesne's generation-related merger savings are 48.34 percent of its net total merger savings during the first ten years. Id. Using this "rule of thumb relationship," Mr. Kahal calculated the year-by-year generation related merger savings, as shown on Schedule MIK-9 for the first ten year. Id. He then increased this amount by a 2.7% escalation rate for the following ten years. Id. To this, he added $2.5 million per year for joint dispatch savings, based on Mr. O'Brien's

estimate, again increasing them by an escalation factor of 2.7%, which was not reflected in Mr. O'Brien's analysis. Id.

In total, Mr. Kahal estimated generation-related merger savings of $152.28 million at 1/1/99 on an after tax basis and net of costs to achieve the savings. Id. at 40 & Sch. MIK-9. The Company did not specifically dispute Mr. Kahal's estimate of merger-related savings in this case, other than to argue that such savings could be addressed in the final valuation. His adjustment should be adopted.

D. Decommissioning

In its filing, Duquesne has identified $123.90 million as a stranded cost associated with the amount needed to fully fund the Company's nuclear and fossil decommissioning obligation. Duq. Exh. DJC-20. The OCA submits that the fossil decommissioning claim should be rejected and that the nuclear decommissioning claim should be modified consistent with the testimony of OCA witness Catlin.[9]

1. Nuclear Decommissioning

In evaluating Duquesne's claim for stranded costs associated with nuclear decommissioning, OCA witness Catlin recommended a change in the treatment of these costs in order to determine stranded costs as of December 31, 1998. He explains the necessity for this adjustment:

> I am proposing to change the treatment of nuclear decommissioning expenses to be consistent with the OCA's proposal to determine stranded costs as of December 31, 1998 rather than December 31, 2005. To accomplish this, I have calculated the annual funding contributions which are required over the years 1999 to 2005 to fully fund nuclear decommissioning costs prior to December 31, 2005.

OCA St. 3 at 18.

In addition, in calculating the annual funding contribution to fully fund the obligation, OCA witness Catlin reduced the contingency allowances contained in Duquesne's decommissioning estimates to reflect a 10% contingency, rather than the contingencies (approximately 20%) contained

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[9] OCA witness Thomas Catlin's qualifications are set forth in OCA St. 3, Appendix A.

in the Company's claim. OCA witness Catlin described the support for his adjustment explaining that:

> In its Order in Pennsylvania Power & Light Company's last rate case at Docket No. R-943271, the Commission eliminated the contingencies built into that company's nuclear decommissioning cost estimates in their entirety. In doing so, the Commission noted that there is no reason to conclude "...that speculative future costs necessitate a large contingency factor which rests, in itself, on estimated costs which are far from certain." (p. 82) More recently, in July 1996, the Commission issued a *Proposed Policy Statement Regarding Nuclear Decommissioning Cost Estimation and Cost Recovery* which stated that: "Cost estimates may not include more than a 10% overall contingency factor..." While a lower contingency factor could be supported, I have reflected an allowance for contingencies at the upper end of the range suggested by the Commission.

OCA St. 3 at 19.

In his analysis, OCA witness Catlin adopted the Company's 4.0% yearly escalation rate and 7.5% earnings rate on the decommissioning trust fund. OCA St. 3 at 19. As a result of his analysis, OCA witness Catlin found the total funding requirements to fully fund nuclear decommissioning for Perry, Beaver Valley 1 & Beaver Valley 2 to be $7,949,000 per year for the seven year CTC recovery period. OCA St. 3 at 20.

2. Fossil Decommissioning

As part of its restructuring filing, Duquesne has also included costs for fossil decommissioning in its stranded cost claim. To determine this amount, the Company deducted the present value of its claimed fossil decommissioning liability from the estimated market value of its generating units as of December 31, 2005. OCA St. 3 at 20.

The OCA submits that Duquesne's claimed fossil decommissioning costs are not properly included in the stranded cost calculation and are not recoverable in this proceeding. In his testimony, OCA witness Catlin explained that fossil decommissioning costs are not properly recovered as a stranded cost. Mr. Catlin set forth the following reasons: (a) there is a great deal of uncertainty over whether dismantling and decommissioning of the fossil facilities will actually occur, and if so, when it will occur; (b) if the Company actually does decommission and dismantle the site, existing generation sites can be quite valuable, as the site contains all the necessary infrastructure

to locate a new generation facility, or may have value for other purposes, benefits not recognized in the studies; and (c) the costs of decommissioning a generating unit are not only applicable to Duquesne but to every electric supplier, and it would be unfair to require Duquesne's ratepayers to fund these costs in advance when competitors will have to derive necessary funds from the market. OCA St. 3 at 21-22.

The Commission recently rejected PECO's claim for fossil decommissioning costs. It stated that "[the Company's] claim for separate recovery of future costs related to fossil plant decommissioning expenses cannot be approved because future or prospective fossil plant decommissioning expenses are not traditionally recognized in rates in Pennsylvania." PECO Order at 91. The Commission explained its reasoning stating:

> Prospective fossil decommissioning expenses are not recoverable under traditional ratemaking 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 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 significant residual "salvage" value, partly offsetting, or even surpassing any cost of decommissioning.

PECO Order at 92.

Therefore, for the reasons stated above, as well as the Commission's decision in the PECO proceeding, the OCA submits that Duquesne's claim for fossil decommissioning expense is not recoverable as a stranded cost under the Act, and should be disregarded.[10]

E. Regulatory Assets and Liabilities

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[10] However, if fossil decommissioning costs are to be recognized, OCA witness Catlin remarked that two adjustments should be made to the Company's calculation. First, the contingency factor for the decommissioning cost estimates should be reduced from 15 to 10 percent. OCA St. 3 at 22. Second, Mr. Catlin noted that OCA witness Kahal has recommended life extensions for several of Duquesne's coal-fired facilities. (See OCA St. 1) The OCA submits that fossil decommissioning costs should take into account the potential for longer lives.

1. Introduction

The OCA has very few disputes with Duquesne regarding its claim for regulatory assets. In large part, the difference in the Duquesne's and the OCA's regulatory asset figures are adjustments to reflect the difference between the Company's stranded cost valuation approach, reflecting the value of regulatory assets as of 12/31/2005, and the OCA's approach which reflects values at 1/1/99, as is consistent with the Act. In addition, the OCA submits that the Company's claims for deferred coal costs and deferred caretaker costs should not be allowed because the conditions for recovery of those items have not occurred.

2. Disputes Regarding Specific Claims

(a) SFAS No. 109 Deferred Taxes

Duquesne sought recovery of its SFAS No. 109 obligation as a regulatory asset. There are two components to Duquesne's SFAS No. 109 obligation, explained by OCA witness Catlin as follows:

> One component of this future tax liability is the future tax obligation associated with tax-book timing for which the benefits have been flowed through to ratepayers. Duquesne has identified this as its "regulatory tax receivable." A second component of this future tax liability relates to the differences between the costs capitalized as part of plant costs for book purposes (basis differences). This component is primarily attributable to the fact that the allowance for funds used during construction (AFUDC) on Duquene's nuclear units was recorded on a net of tax basis. Duquesne has identified this future tax liability as "SFAS No. 109 plant."

OCA St. 3 at 16. The OCA's adjustment relates to the "SFAS No. 109 plant".

Duquesne, under its methodology proposed in the case, removed the SFAS No. 109 plant tax liability from the balance of plant in service and included it as regulatory asset. OCA St. 3 at 16. The OCA does not dispute that this was necessary under the Company's approach to properly recover the SFAS No. 109 plant obligation. However, under the OCA's analytical framework, this adjustment must be reversed. OCA witness Catlin explained:

> This is necessary because the SFAS No. 109 plant tax liability is included in the plant balances associated with the Company's nuclear generating units as of December 31, 1998. Since Mr. Kahal is utilizing the plant balances as of December 31, 1998 to determine stranded costs, he has already accounted for the SFAS No. 109 plant

> tax liability in his analysis and it is unnecessary to also include this balance as a regulatory asset.

OCA St. 3 at 17.

Duquesne witness Clayton acknowledged in rebuttal testimony that this balance could properly be reclassified, as Mr. Catlin recommends. Duq. St. 2R at 18. The removal of the SFAS No. 109 plant balances reduces the balance of Duquesne's regulatory asset claim by $62.94 million. The OCA and Duquesne agree that this represents the proper net present value of this obligation.

(b) Unamortized Debt Costs

Based on its overall approach to determining stranded costs, Duquesne divided its unamortized debt costs into two components. OCA St. 3 at 7. OCA witness Catlin explained these components as follows:

> The first component is the portion of those costs which will be recovered through interest expense in the year 1999 through 2005 as part of the Company's revenue requirements. The second component is the portion of the unamortized debt costs which would otherwise be recovered as interest expense subsequent to 2005. This second component was treated as a generation-related regulatory asset.

OCA St. 3 at 7.

Under this method, Duquesne included $29.92 million of unamortized debt costs as a regulatory asset and identified an additional $16.76 million of unamortized debt costs as being recovered through interest expense, for a total of $46.68 million. OCA St. 3 at 8.

The OCA, however, is recommending a different approach to the determination of stranded costs -- specifically that a determination of stranded costs be made as of December 31, 1998, as described above. As a result of this approach, the full generation-related balance of unamortized debt costs as of December 31, 1998 should be recognized as a regulatory asset. OCA St. 3 at 7-8. OCA witness Catlin recognized a balance of unamortized debt as of December 31, 1998 of $45.77 million as regulatory asset (exclusive of the unamortized debt costs associated with the Beaver Valley 2 sale/leaseback), which he has proposed to treat as a regulatory asset eligible to earn a return during the recovery period. OCA St. 3 at 8. Since these are treated as a regulatory asset,

OCA witness Kahal adjusted Duquesne's claimed cost of debt to exclude recognition of the unamortized debt cost.

In rebuttal, Duquesne witness Clayton criticized Mr. Catlin's treatment of unamortized debt cots, claiming that such treatment would penalize the Company by reducing its overall cost of capital and raising the apparent leverage of the Company. Duq. St. 2R at 22-23. The Company's argument is incorrect and should be rejected. As OCA witness Catlin explains:

> The argument that the Company is penalized is simply not accurate. The treatment which the OCA has afforded unamortized debt costs assures the Company of full recovery of those costs by amortizing the balance over seven years and providing a return on the unamortized balance. The reduction to Duquesne's overall rate of return which results from excluding unamortized debt costs is offset by my adjustment to increase the regulatory asset attributable to unamortized debt costs by $16.76 million compared to the Company's claim.

OCA St. 3S at 4.

The OCA submits that Duquesne's unamortized debt costs as of December 31, 1998 should be treated as a regulatory asset in the amount of $45.77 million, consistent with the testimony of OCA witness Catlin.

(c) Unamortized Sale/Leaseback Premiums

As a financing vehicle, Duquesne converted its ownership interest in the Beaver Valley 2 nuclear generating station into a sale/leaseback arrangement. In this proceeding, the Company has included a portion of its claim for this asset as a regulatory asset and a portion as an owned-generation asset. OCA St. 1 at 21. However, Duquesne remains, for all practical purposes, the owner of this asset and, as discussed above, the OCA has included all of the costs of the Beaver Valley 2 sale/leaseback as an owned-generation asset. Id. To that end, OCA witness Catlin calculated the net present value of the lease payments and amortization from 1999 through the end of the lease and provided these numbers to OCA witness Kahal for use in his analysis of owned-generation stranded costs. OCA St. 3 at 9. In making this calculation, OCA witness Catlin used the same amounts for the annual lease payments and the amortization amounts for issuance costs and refinancing premiums as the Company. Id. Mr. Catlin utilized OCA witness Kahal's discount rate

of 6.88% to determine the net present value of these costs and then removed $63.66 million to reflect the benefits of the Ft. Martin sales agreement, resulting in a Net Present Value amount of $513.36 million at the OCA's discount rate. Id. at 10.

While Duquesne disagrees with the OCA's proposal to deny a return on owned-generation assets during the CTC recovery period, Duquesne witness Clayton stated that "the Company has no particular quarrel with [the OCA's] treatment." Duq. St. 2R at 24. Thus, the OCA submits that its quantification of these costs is appropriate.

(d) Deferred Rate Synchronization Costs -- Not an OCA issue.

(e) Deferred Employee -- Not an OCA issue.

(f) Deferred Coal Costs

Duquesne has included $13.5 million in deferred coal costs in its regulatory asset claim. Duq. St. 4 at 13. This balance represents the amount that Duquesne paid for coal from the Warwick and Mansfield mines in excess of the amount that it was permitted to roll-in through its ECR, under the terms of the settlement reached by the parties and approved by the Commission in Docket Nos. P-00880386 and P-00890387. Petition of Duquesne Light Company for Order Establishing a New Coal Cost Standard, Docket Nos. P-00890386 and P-00890387, slip op. (June 15, 1990). Duquesne witness O'Brien argues that the settlement provided for recovery of these deferred coal costs at some future time. Duq. St. 4 at 13.

OCA witness Catlin has recommended that Duquesne's entire deferred cost claim be denied. Mr. Catlin explains his reasoning as such:

> The settlement in those dockets allowed the Company to defer costs in excess of a market based price cap for future recovery at such time as its costs were less than the capped price. ... To the extent actual costs did not fall below the market based price cap, the settlement did not provide any other mechanism for the recovery of the deferred costs. In other words, the settlement did not provide assured recovery of any costs which Duquesne was required to defer because the price paid for coal exceeded the price cap.

OCA St. 3 at 13-14. As such, the OCA submits that these coal costs are not eligible for recovery in this case.

(g) Deferred Caretaker Costs

Duquesne has claimed $6,770,00 to be recovered as a regulatory asset for the costs associated with the maintenance of the Phillips and Brunot Island units during their time in cold reserve. Duq. St. 4 at 7, 14. Duquesne has stated that the Commission approved recovery of these costs in Docket P-900485. Duq. St. 4 at 14. See Petition of Duquesne Light Co. for Declaratory Order, P-0090485, slip op. (April 2, 1992).[11]

The OCA submits, however, that Duquesne is incorrect. No assurance of recovery of these costs was provided by the Commission. Mr. Catlin explains:

> That settlement allowed Duquesne to defer the costs for preserving the Phillips and Brunot Island units while they were in cold reserve until those units were reactivated. The settlement provided that recovery of the deferred caretaker costs was only to take place at the time the units were returned to service. No provision or assurance was made for recovery of the deferred costs if the units were not returned to service.

OCA St. 3 at 15.

In this proceeding, Duquesne has not proposed to return the Phillips and Brunot Island units to service. Duq. St. 4 at 14-15. Therefore, Duquesne is not entitled to recover deferred caretaker costs as a regulatory asset. If the units are later returned to service, OCA witness Catlin explains, "it will be because the revenues produced will exceed Duquesne's ongoing costs. If this occurs, then Duquesne will recover its deferred costs from the margins generated." OCA St. 3 at 15. The OCA submits that there is no basis for the recovery of deferred caretaker costs and the $6,770,000 should be removed from Duquesne's regulatory asset claim. Consistent with the OCA's treatment of deferred coal costs, the Company has not shown that its condition for recovery -- that Phillips and Brunot Island will be returned to service -- is expected to occur. Consistent with this view, the Company has not recognized any market revenues from these units to help recover the

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[11] At the time of Docket No. P-900485, it was anticipated that these units would be returned to service in conjunction with a proposed power sale between Duquesne and the GPU companies. Recovery of the investment in the Phillips and Brunot Island units, including deferred caretaker costs, was to take place through the power sales clause to be implemented in conjunction with the sales. The transaction with GPU was never completed. OCA St. 3 at 15.

undepreciated book investment. OCA St. 3 at 15. For the reasons set forth above, the OCA submits that this claim should be denied.

(h) Pre-Accrual of Nuclear Outages

Historically, Duquesne has accounted for, and been allowed to recover, nuclear maintenance outage costs by deferring those costs when incurred and amortizing them over the interval between outages. In this filing, Duquesne has proposed to revise that treatment by accruing the costs prior to the outage taking place and has included the pre-accrual of these costs as a regulatory asset to be recovered through the CTC. Duq. St. 4 at 12.

OCA witness Catlin evaluated this claim and has excluded these costs from his regulatory assets analysis, as they are included in OCA witness Kahal's cash flow analysis for Duquesne's nuclear plants. OCA witness Catlin explains:

> In determining the stranded costs associated with Duquesne's company-owned generating units, my associate, Mr. Kahal, has relied on the cash flow analysis provided by Duquesne which compares projected market revenues to generating unit operating costs. The projected operating costs for the Company's nuclear units include the full cost of the maintenance outages in the years the costs are projected to be incurred. Therefore, there is no basis for including a regulatory asset for the pre-accrual of those same costs under the OCA methodology. To do so would result in double-counting of the costs for which the pre-accrual is made.

OCA St. 3 at 11.

In rebuttal testimony, Duquesne witness Clayton excepted to the OCA's treatment of pre-accrued nuclear outage costs saying that it would deny Duquesne recovery of its projected nuclear outage costs. Duquesne St. 2R at 29. On this point, Mr. Clayton is simply incorrect. OCA witness Catlin restated in surrebuttal that these outage costs are already included in the OCA's stranded cost analysis and thus would not deny the Company any recovery. OCA St. 3S at 2. Thus, the OCA's method should be adopted.

(i) Transition Costs -- Not an OCA issue.

3. Conclusion

The OCA submits that the regulatory assets determined by Mr. Catlin are the reasonable and

appropriate level of recovery for Duquesne's regulatory assets.

F. Recovery Of Stranded Costs

1. Introduction

As discussed above, the reasonable level of the Company's owned-generation stranded costs at 1/1/99 is $1.020 billion. Table 1. Adding on regulatory assets of $330.84 million, which includes other transition costs of $18.20 million, produces net stranded costs, on a stand-alone basis, at 1/1/99 of $1.351 billion. Id. Subtracting out $152 million in merger-related savings produces stranded costs for the merged entity of $1.199 billion. Id. Of this amount, 0.1 percent should be allocated to the FERC jurisdiction. Id., n. 3.

The Act provides for recovery of stranded costs for a period ending on December 31, 2005 unless the Commission in its discretion and for good cause shown orders an alternative payment period. 66 Pa.C.S. § 2808(b). It is OCA's position that the Company should be permitted to recover its stranded costs over this period. Consistent with the Act, OCA submits that, as a means of sharing stranded costs, the Company should not be permitted to recover a return on the unamortized balance of its owned-generation stranded costs.

As indicated above, OCA is also opposed to the Company's proposal to continue rates at the capped level subject to a final valuation in 2003 and its related proposals to commit to a minimum level of accelerated depreciation and amortization and its proposed ROE spillover mechanism. Instead, the Company should recover its stranded costs based on the amount of stranded costs determined in this proceeding. Further, to the extent that current rate levels exceed the sum of allocated T&D costs and the CTC (as delineated below), the generation portion of the Company's rates should be decreased to a market-based level. OCA would expect that this decrease would occur through two mechanisms. First, until all customers have access to an alternative provider of electric generation, the generation portion of Duquesne's customers' rates should be reduced to the level necessary to recover the OCA estimated market price of generation and the CTC. For customers who, during this transition period, have a choice of alternative providers, they would be

responsible only for the CTC portion of this rate; in other words, the "Competitive Generation Credit" (i.e., the amount by which customers bills to the utility are reduced to reflect its use of an alternative supplier) should be set as the difference between total generation-related rates at this lower level and CTC costs.

After the phase-in period and until January 1, 2006, the Company's generation rates should reflect prevailing market prices as established purusant to Section 2807(e)(2) and (e)(3) of the Act up to the level of the rate cap. After January 1, 2006, generation rates for Duquesne's remaining generation customers will still be set at prevailing marrket rates, but will no longer be affected by the rate cap.

2. Proposals to Adjust the Level of Stranded Cost Recovery

a. Mitigation

As noted above, the Company's proposal incorporates a commitment to amortize $1.8 billion of stranded costs over the CTC recovery period if current rate levels are maintained, and it intends to adjust that commitment to reflect merger benefits if the merger is approved. Tr. at 46. However, as discussed above, OCA submits that the Company will have greater incentives to mitigate stranded costs if they are determined in this proceeding.

b. Sharing of Stranded Costs

As indicated previously, the Act provides for recovery of the Company's net non-mitigable stranded costs, requires that the Commission allow recovery of regulatory assets and NUG buy-out costs, but gives the Commission discretion in determining the reasonable level of owned-generation stranded costs that the Company may recover. As discussed below, OCA submits that the Commission should allow the Company to recover, on an amortized basis, its owned-generation stranded costs, but that it should not be allowed a return on the unamortized balance of such costs during the recovery period.

As indicated above, Duquesne's owned generation stranded costs of $1.020 billion on a stand-alone basis, are substantial, and are only slightly lower than the net book value of all of its

generating units. As OCA witness Kahal testified, what is striking about these amounts is that "virtually the entire amount is attributable to Duquesne's three partially owned nuclear units." OCA St. 1 ar 41. Indeed, when life extension benefits are considered for the non-nuclear units, "there are no significant stranded costs" associated with the Company's non-nuclear units. Id. The significant level of stranded costs associated with the nuclear units exists even though the nuclear units account for only about one-quarter of Duquesne's installed capacity. Id.

Mr. Kahal explained why Duquesne's nuclear units have presented such a problem:

> There are two reasons why the nuclear units produce such a serious problem for Duquesne. First, the investment costs, and hence the net book values, are very high, despite the progress made under the Ft. Martin initiative. Second, the operating costs of these plants are very high making it very difficult to generate significant net margins from competitive market sales. Hence, there is little net revenue to offset net book value. There is little doubt that these plants should be considered to be "economic excess capacity" if this were a standard rate case.

Id.

OCA witness Kahal testified that in light of the "just and reasonable" standard for recovery of owned-generation stranded costs and the fact that virtually all of the Company's stranded costs are "economic excess capacity," a sharing of such costs is clearly appropriate. Id. This is consistent with established ratemaking policy and practice in Pennsylvania which has allowed the Commission to deny a return on capacity which is not used and useful or which constitute uneconomic excess capacity. See, e.g., Philadelphia Elec. Co. v. Pennsylvania Pub. Util. Comm'n, 61 Pa. Commw. 325, 433 A.2d 620 (1980) (Commission excess capacity disallowance of the full return on several existing power plants that had previously been included in rates upheld by the Commonwealth Court) and Pennsylvania Elec. Co. v. Pennsylvania Pub. Util. Comm'n, 509 Pa. 324, 502 A.2d 130 (1985), appeal dismissed sub nom., Metropolitan Edison Co. v. Pennsylvania Pub. Util. Comm'n, 476 U.S. 1137 (1986) (Pennsylvania Supreme Court upheld the Commission's decision toexclude from rates the utilities' investment in Three Mile Island Nuclear Station, also finding that the financial well-being of the utility is but one aspect of the balancing test); Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) (upholding a ruling that a utility could be denied any return on or recovery of canceled plant

costs, even though the costs were admitted by all parties to be prudently incurred). Additionally, Section 1315 of the Public Utility Code codified the long-standing principle that electric utility assets which are not "used and useful" in providing service to the public should not be included in rates. 66 Pa.C.S. § 1315.

Mr. Kahal recommended that a reasonable sharing of such costs would be to allow the recovery in transition charges of the principal amount of the owned generation stranded cost over the seven-year transition period, but with no return applied to the unamortized balance. Id. Mr. Kahal explained why a sharing in this way is reasonable in comparison to Duquesne's proposal to recover 100% of stranded costs:

> Given the circumstances, Duquesne's position that ratepayers must absorb 100 percent of stranded costs for the Company's uneconomic nuclear units is not reasonable. It is inconsistent with past ratemaking policy in Pennsylvania, which has not allowed a return on plant which was not used and useful. Duquesne's expensive nuclear plants are not used and useful in the sense that they do not provide a net economic benefit to customers. Shareholders who are accountable for these past nuclear investments, and who have benefited in recent years from the Company's favorable earnings, should bear some of the costs of these uneconomic investments.

Id. at 42.

While OCA submits that Duquesne should not be provided a return on these investments through stranded costs, OCA would note that it is, nonetheless, possible that the Company will be able to earn a return on this investment if Duquesne is able to realize efficiencies that have not been assumed in OCA's analysis. Id. at 42-43. As Mr. Kahal noted, the Company's stranded costs are primarily limited to its nuclear units and it can expect to earn reasonable, very attractive returns in the competitive market on its coal plant investment. Id. Furthermore, with respect to its nuclear investment, if the Company is able to lower operating costs and improve performance, it may be able to generate positive margins on those plants. Id. For example, as Mr. Kahal points out, OCA witness Smith's analysis assumes less optimistic nuclear plant availability than Duquesne itself has assumed and believes it can achieve. Id. Mr. Kahal has also made the convservative assumption that Duquesne's cold reserve capacity has no market value. Id.

In light of the above, OCA submits that a reasonable and appropriate sharing of Duquesne's stranded costs is provided by not allowing a return on the unamortized balance of its owned-generation stranded costs during the transition period.

c. Securitization (DII Proposal)

3. Methods of Stranded Cost Recovery

In large part, the issues associated with this subject have been discussed previously in Section IV(A) above, which provides an overview of stranded cost valuation and recovery approaches. OCA will discuss here the implications of the evidence on these policy issues.

a. Accelerated Amortization under Section 2804(4)(v)

As indicated above, OCA believes that the Company's approach of maintaining its rates at current levels subject to a future final valuation and subject to the ROE spillover is inconsistent with the law and unwise in that it will (1) unnecessarily postpone the determination of the CTC resulting in uncertainty to ratepayers, (2) likely require the establishment of a false proxy for the market price, (3) deny ratepayers the benefits of any near-term rate savings, (4) remove incentives to mitigate stranded costs, and (5) would require substantial regulatory oversight that is inconsistent with the objectives of the Act.

It is important to recognize that, even if the Company's interpretation of Section 2804(4)(v) is accepted, that section does not suggest the postponement of the Commission's decision with respect to the appropriate level of stranded costs. Thus, assuming the Commission determines stranded costs in this proceeding, the Commission must be satisfied that leaving rates at current levels will not produce excess earnings during the CTC recovery period or windfall profits for the Company at ratepayer expense in the competitive market. OCA submits that this is not possible given OCA's valuation of stranded costs, which indicates that rates would have to be reduced by 18% over the CTC recovery period to avoid that windfall. See OCA St. 4-S, Exh. LS-9 (Revised LS-5). Moreover, even under the Company's own analysis, when factors such as merger savings and life extension of plants are considered -- which the Company has recognized need to be taken into

account, the Company's position that it will not have excess earnings does not appear probable. OCA St. 1 at 10-11.

Thus, the Company's stranded cost recovery proposal is entirely dependent on the Commission's adoption of the Company's final valuation proposal and everything which it entails, including the proposed ROE spillover mechanism. Given the numerous problems raised with that proposal, OCA submits that it should be plainly rejected in favor of a current valuation of stranded costs and an adjustment to rates in this proceeding.

b. Immediate Rate Reductions (OCA Proposal)

As indicated above, OCA has proposed the establishment of a specific CTC, specific T&D rates, and a specific market price of generation (avoidable generation component). Ratepayers who remain with Duquesne should only be required to pay the sum of these components. OCA submits that if the sum of these components produces a rate below the current rate, customers should realize a rate reduction.

There is one difference between the Commission's approach in its Order in the PECO case and that recommended by OCA in this proceeding. In the PECO case, customers can receive rate reductions only if they select an alternate supplier and that supplier's charges are less than the shopping credit provided by PECO. In contrast, under OCA's proposal in this case, all customers will receive a rate reduction and alternate suppliers will have to compete based upon their ability to provide favorably priced electric generation when compared to the generation price reflected in the Company's rates.

OCA respectfully submits that the approach taken in the PECO case should thus be modified in this case. There are a number of reasons that this should be done. First, and perhaps most important, is that all customers will benefit from the OCA approach, not just those who leave Duquesne's generation service. Moreover, Section 2807(e)(3) of the Act makes clear that, after the phase-in period ending no later than on January 1, 2001, customers who do not choose are to be served by the utility or a commission-approved alternative supplier at "prevailing market prices,"

subject to the rate caps established in § 2804. 66 Pa.C.S. § 2807(e)(3). Certainly, the Commission should not provide an incentive to competition which will suddenly disappear two years after the beginning of competition.

In light of the above, the most reasonable approach in this case is to implement the approach set forth by OCA above. OCA's specific proposal in this respect is set forth below.

c. Rate Cap/CTC Extension

d. Other Proposals

4. Other Arguments Regarding Recovery of Stranded Costs

5. Conclusion

In light of the substantial uneconomic costs related to Duquesne's nuclear investment, OCA submits that it is appropriate that owned-generation stranded costs be shared by denying the Company a return on the unamortized balance of its stranded cost recovery during the CTC collection period. Further, all ratepayers should realize the benefits of restructuring by reducing rates to a level that produces a just and reasonable rate level during that period.

G. Conclusion

OCA submits that the reasonable level of stranded costs which the Commission should allow Duquesne to recover is $1.351 billion, as shown on Table 1 (attached). Of this, the Commission should allow recovery of $1.020 billion in owned-generation stranded costs, but should deny a return on the unamortized amount during the recovery period. Additionally, the Commission should allow $330.84 million in regulatory assets, including $18.20 million in other Transition costs, plus a return on such assets. The Commission should reduce generation rates to provide recovery of the Company's stranded costs and generating assets and should reject the Company's proposed final valuation and rate cap proposals as inconsistent with the law and the objectives of the Act.

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 competitive transition charge, or "CTC," is the charge which the Act provides for recovery of transition costs from customers. 66 Pa.C.S. § 2808. The Act allows application of the CTC only through December 31, 2005 ["the CTC recovery period"] "unless an alternative payment methodology is mutually agreed upon by the customer and the utility or unless the commission in its discretion and for good cause shown orders an alternative payment period." 66 Pa.C.S. § 2808(b).

The competitive generation credit, "CGC," also referred to as the "avoidable generation charge" or "shopping credit," on the other hand is not a charge, but is simply the amount of the utility's charges that a customer will not have to pay if the customer purchases generation from an alternative supplier. DLC St. 5 at 63. The CGC is a regulatory concept and is nowhere defined in the Act, and in this case, and for different purposes, parties have defined, and calculated, the CGC in different fashions.

The simplest way to look at the issues surrounding the determination of CTCs and CGCs is to start by looking at the total rate of the utility. As shown on OCA witness Lee Smith's Exhibit LS-7R (attached), the Company's current total average rates is 8.930¢/kWh. Subtracting out Ms. Smith's calculations of the appropriate unbundled charges for Transmission and Distribution combined of 2.211¢/kWh as shown on Exhbit, LS-7, the remaining revenue at current rates is 6.719¢/kWh, which is available to cover the Company's remaining costs, i.e. its embedded generation costs including administrative and general costs that have been allocated to generation. Further, embedded generation costs in this case are broken down by those costs which can be recovered at market prices, and those costs which are stranded, i.e. are in excess of market prices, which are designed to be recovered through the CTC.

In the Company's view of the world, it should be permitted to recover the full 6.719¢/kWh from customers who remain with the utility because even if it recovers this full amount, it will still have stranded costs at the end of the CTC recovery period. Further, for customers who opt to take generation service from an alternative supplier, the Company would subtract out the market price

of generation, and the residual would be the CTC. Under the Company's analysis, the CGC would be the 1-year auction price of 1.81¢/kWh, which is separately stated by customer class on Mr. Lahtinen's Schedule JAL-11. In contrast, OCA's analysis indicates a market price for 1999 including avoidable generation-related A&G, of 2.529¢/kWh, based on Mr. Smith's analysis of market prices and Ms. Smith's analysis of generation-related A&G during 1999.

The problem with the Company's approach is that the CTC would be set at a level (4.19¢/kWh) significantly higher than is necessary to recover stranded costs. The consequence of this proposal would be that, in OCA's view, the Company would significantly overrecover its stranded costs during this period.

In place of this proposal, OCA has proposed that the CTC be designed to recover the amount of stranded cost that the OCA has found to be appropriate for recovery from ratepayers. The CTC could be designed in several different ways. For example, it could be designed to provide levelized collection of stranded costs, declining CTC, levelized rate reduction, or a levelized charge. OCA has proposed a levelized rate reduction which utilizes a declining CTC. As Ms. Smith testified, a levelized rate reduction produces a smaller financial impact on the Company than a levelized CTC, because it results in smaller rate reductions in the earlier years. OCA St. 4-S at 9.

Other parties have proposed setting the CGC, or "shopping credit" as the residual, and the PECO Order adopts this approach. However, OCA submits that this approach to CTC rate design should not be adopted for a number of reasons. In particular, OCA submits that it is inappropriate to establish generation rates which allow Duquesne to charge excessive generation rates to customers who either (1) do not have the choice of an alternative supplier, or (2) choose to remain with the utility during the transition period due to the absence of real competition.

2. Other Conceptual Disputes

a. CGC Calculation: Annual Adjustments v. Fixed Schedule

Part of the Company's final valuation proposal is to adjust the CGC annually to reflect market prices. Annual adjustment of the CGC presents a number of problems. Perhaps most important is

that there may be significant controversy over the price which is produced by Duquesne's auction, requiring Commission monitoring and possibly review of this process. Additionally, use of an annual auction would make it difficult to establish rates during the CTC recovery period today. Consequently, OCA recommends that the Commission reject this approach in favor of setting the CGC in this proceeding.

b. Determination of Class Responsibility for Stranded Costs

The Act requires that stranded costs be allocated "in a manner that does not shift interclass or intraclass costs and maintains consistency with the allocation methodology for utility production plant accepted by the commission in the electric utility's most recent base rate proceeding." 66 Pa.C.S. § 2808(a). Consistent with this language, OCA witness Lee Smith recommended allocation of stranded cost responsibility to each class on the basis of the production capacity allocator utilized in the Company's last rate case." OCA St. 4 at 9. Ms. Smith pointed out that using a class residual CTC as proposed by the Company, and by DII, will likely produce results which are inconsistent with the allocation of stranded costs on the basis provided in the statute. Id. at 8-9. In particular, customer classes with discounted rates, such as Rule 4 customers, would pay lower CTCs if CTCs are set as the residual than if they are based on a specific allocation. Id. at 9. Further, if the CTC residual process were utilized for the entire CTC collection period, then discounted rate customers would end up being subsidized by other customer classes. Id.

In his Rebuttal Testimony, DII witness Baron contended that use of an allocation approach would violate the generation rate cap for several classes. DII St. 1R at 17. Mr. Baron contends that it would produce this result because the allocator doesn't reflect the fact that some HVPS sales are either interruptible, or entail "avoidance generation energy" and should result in lower responsibility for capacity. Id. However, as pointed out by OCA witness Lee Smith, the allocator was determined in the last base rate case after consideration of all factors utilized in the last base rate case does not recognize these characteristics. OCA St. 1-S at 7. Thus, Mr. Baron is simply criticizing the allocator as "being outdated or otherwise incorrect." However, the Act does not specifically allow for any

"corrections" to previously utilized generation cost allocators. Id. In light of this dilemma, OCA witness Smith recommended that if allocation of the basis of utility production plant would result in violation of the rate cap for some classes, the Company must forgo these revenues "unless, for good cause shown, it requests and is granted a longer collection period for these classes." Id.

The Commission's Order in the PECO case adopted Ms. Smith's recommendation for use of the utility production plant allocator. PECO at 109-13. OCA submits that the same approach should be adopted here.

c. Levelized CTC v. Other Methods

As discussed above, OCA recommends the establishment of a levelized rate reduction. As shown on Exhibit LS-7 (Revised), a levelized rate reduction calculated to allow full recovery of stranded costs, *produces a declining* CTC because of the estimated increase in market prices. Using this approach, Ms. Smith calculated sample residential rates. OCA recommends this approach.

d. Duquesne's Rate Redesign Proposal

The Company has proposed a two-part Customer Transition Charge which includes a fixed (customer-specific) charge and a usage-based (class-specific) charge, based on the Company's view that a lower usage-based charge will encourage greater consumption and, thereby, mitigate stranded costs. DLC St. 5 at 32-47. The result is a relative increase in fixed cost recovery from customers who use less generation, and a relative reduction in rates for customers who use more. OCA submits that this is an unreasonable result. OCA submits that *the efficiency benefits of the rate* redesign are speculative and the proposal should be rejected. OCA St. 4 at 8; OCA 4-S at 7-8. OCA submits that promotional rates that encourage greater energy usage are inappropriate.

e. Other Conceptual Disputes

i. Calculation of the CGC/Avoidable Generation Credit

Company witness Lahtinen proposed to determine the CGC -- the avoidable generation credit -- by taking the market price established in Duquesne's RFP, developing rates for each individual

rate class based on hourly market values and class load shapes, and then adjusting that price for transmission and (as modified in rebuttal) distribution losses and gross receipts tax. DLC St. 5 at 56-57; DLC St. 5-R at 21-22 & JAL-15. Sample pro forma CGCs are shown in Exhibit JAL-11 for each rate class based on the most recent RFP.

Consistent with OCA's recommendations, OCA witness Lee Smith designed the CGC beginning with the use of Mr. Smith's market price projections which are presented as an all-hours market price. OCA St. 4 at 11. Because data for each rate class was unavailable, Mr. Smith also calculated a load-following market price using the combined Duquesne and APS load shape for 1999 through 2005. Id. Ms. Lee Smith then adjusted these market prices for line losses using the ratio of total generation to total sales as reported in FERC Form 1, which was 5.1% and for GRT. Id. These calculations are shown in Exhibit LS-2. Id. Ms. Smith testified that class specific CGCs should be calculated from class load shapes when such data is available. Id.

Ms. Smith then adjusted this price to reflect normal costs that will be required to bring this power to the retail market. Id. at 11-12. These include "administrative and general costs that will be required to market, aggregate load, reconcile load and supply, write contracts" and other activities necessary to get power to customers. Id. Ms. Smith estimated these costs from the Company's COS study, including pensions, benefits and insurance that are reflected in on-going production costs, regulatory expenses, and other A&G, consistent with Mr. Catlin's allocation of A&G in his testimony. Id. The result is an addition of 0.368¢/kWh ($1999) which she adjusts for inflation through the CTC recovery period. OCA St. 4-S at 8-9; Exh. LS-7 Revised (attached).

While Company witness Lahtinen contends that there is evidence that marketers are willing to serve retail customers at levels close to (or even below) wholesale market prices, Mr. Lahtinen misses the point. DLC St. 5 at 62. The point is that by recovering through the regulated portion of rates costs that competitive suppliers incur, the Company gains an unfair competitive advantage. OCA St. 4 at 13. OCA submits that this adjustment should be adopted.

ii. Class Reconciliation of CTCs

Consistent with the statutory requirement for annual reconciliation and with OCA's proposal to allocate stranded costs by rate class, stranded costs should also be reconciled annually on a class-specific basis. OCA St. 4 at 14-16. This approach is necessary to avoid inter-class stranded cost shifting and was specifically adopted in the PECO Order, slip op. at 113.

iii. ECR Roll-in Issue

The Company proposes to roll its Energy Cost Rate (ECR) in at a rate higher than was in effect on January 1, 1997. DLC St. 2 at 8. Specifically, the Company proposes to include energy costs at a rate of 14.7 mills/kWh even though the applicable rate at the effective date of the Act was only 12.8 mills/kWh. Id., n.1. The Company claims that it should be entitled to charge a rate of 14.7 mills/kWh because the Ft. Martin settlement established this as the cap on ECR rates. Id.; DLC St. 5-R at 59-60.

While OCA's proposal to provide immediate rate reductions would render Duquesne's proposal moot, OCA submits that, if a different approach is adopted, rates should not be permitted to be implemented at a level which is higher than was in effect on January 1, 1997, the effective date of the Act. 66 Pa.C.S. § 2804(4)(ii). Although Duquesne's rate cap could reflect the higher rate allowed in the Fort Martin settlement, the Company is not entitled to that higher rate unless it is justified by higher actual fuel costs. Furthermore, as OCA witness Kahal testified, the rate increase should be rejected because the Company's own projections indicate that Duquesne's earnings are expected to be very strong and its rates are already among the highest in the state. OCA St. 1 at 12.

VI. RETURN ON EQUITY

OCA submits that a return on equity of 10.0% should be utilized in determining the level of stranded costs at 1/1/99, consistent with the Commission's adoption of a 10.0% return on equity in PECO's securitization proceeding and in the PECO Order as part of adoption of OCA's Market Value estimate. PECO Order, slip op. at 101.

VII. SPECIAL CUSTOMER CLASSES

A. Rule 4 Contracts

As discussed in Section V(A)(2)(b), OCA submits that the Company's CTC rates to other classes should not be increased to recover stranded costs which are allocated using a utility production plant allocator, but cannot be recovered from such customers because of contractual limitations it has with Rule 4 customers.

VIII. COMPETITIVE SAFEGUARDS

A. Code of Conduct

In its filing, Duquesne submitted a proposed Code of Conduct to apply to the Company's provision of regulated and unregulated services. Duq. Exh. FH-2. OCA witness Alexander reviewed the Company's filing, as well as Codes of Conduct adopted in Massachusetts and California, and made recommendations to address several gaps in Duquesne's Code of Conduct. OCA St. 5 at 53. Specifically, she notes the Company's failure to propose its future corporate structure under retail competition. OCA St. 5 at 54. Additionally, Ms. Alexander made the following proposals, discussed in detail in her testimony, to supplement or clarify Duquesne's proposed Code of Conduct:

1. The proposed Standards should distinguish between the "transmission or distribution function" and the "generation function".

2. There should be no subsidization of the unregulated affiliates or divisions by the regulated division, which is accomplished by permitting the regulated affiliate to purchase only generally available tariffed items and strictly defining any shared A&G support services.

3. The Duquesne Light regulated utilities and the corporate marketing affiliate should not conduct joint marketing.

4. Completely sensitive information should not be transmitted to employees providing unregulated services unless the information is already available and known to be available (through an OASIS-type data central system) to nonaffiliates.

5. The dispute resolution procedure to address complaints alleging violations of the Code of Conduct should include, at a minimum, a procedure to designate a person to conduct an investigation of the complaint and report the results of this investigation to the complainant in writing within 30 days after the complaint is received, including a description of any action taken in response to the complaint and the complainant's option to complain to the PUC if not satisfied with the results of the investigation.

OCA St. 5 at 54-56. The OCA submits that proper resolution of the Code of Conduct is a critical

issue and will have a great deal to do with the development of a competitive market. OCA St. 5 at 53.

With regard to EDC conduct in the context of an Application for Service, Ms. Alexander recommended certain minimum procedures to guard against the use of Duquesne's regulated entity to unfairly market the unregulated entity. OCA St. 5 at 34-36. Ms. Alexander's proposals are set forth fully in her testimony.

The Commission also addressed this issue in PECO and found that it was appropriate to adopt an interim Code of Conduct that contained appropriate detail to apply before the regulations concerning competitive safeguards and customer supplier interaction are adopted. PECO Order at 129. Additionally, the Commission also made a number of changes to the Company's proposed Code of Conduct to address the need to have functional separation between the Company's regulated and unregulated entities and comparable direct access for all affiliates. PECO Order at 129-131. The OCA agrees with the Commission's concern and submits that Duquesne be directed to adopt OCA witness Alexander's modifications to its proposed Code of Conduct.

B. Pro Forma Tariffs--Not an OCA issue.

IX. DUTY TO SERVE

A. Service to Returning Customers

As the competitive market develops, a customer who has been "phased-in" and who has chosen to select an alternate energy supplier may want or need to return to Duquesne for generation service. The OCA submits that the provisions of Chapter 56 will continue to apply to this customer, and the §2804 rate caps will still apply. OCA St. 5 at 49-51. However, Duquesne has also proposed that a customer who returns to Duquesne must remain on the Company's system for a minimum 12-month period.

OCA witness Alexander explains that there may be a number of reasons that a customer returns to Duquesne, and the 12-month requirement will serve to "discourage customers from freely entering the competitive market." OCA St. 5 at 52. Ms. Alexander submits that, "the Company's

concerns about gaming will be met by its proposal to price this service closer to market prices (subject to the rate caps discussed above) or by imposing an appropriate fee when the customer makes use of this service more than twice in any 12-month period." OCA St. 5 at 52. As such, the OCA submits that the Company's proposal is overly broad and restrictive and should not be adopted.

B. Provider of Last Resort

Even as the market develops, there will be customers who choose not to shop, are unable to find an alternative provider to serve them, or who may return to Duquesne for service for a variety of reasons. Duquesne has, by statute, the "full obligation to serve" these provider of last resort ("POLR") customers, at least during the CTC or ITC collection period or until 100% of customers have choice, whichever is longer, unless an alternative supplier is approved by the Commission to provide this service. 66 Pa.C.S. §2807(e)(1). By the end of the phase-in period, the Act requires the PUC to develop regulations to govern the POLR service. 66 Pa.C.S. §2807(e)(2). In its restructuring filing, Duquesne proposed to provide this service by pricing the power supply portion of its unbundled bill based on prices obtained from a competitive RFP process. OCA St. 5 at 51. Although Duquesne has made this proposal to explore competitive solicitation, the OCA submits that more detail is required before this proposal is adopted. OCA St. 5 at 51. Therefore, the OCA recommends that the Commission refrain from adopting Duquesne's proposal at this time. This should be considered as part of the regulatory process that will determine how to set "prevailing market prices" for Duquesne or an alternative POLR pursuant to Sections 2807(e)(2) and (3).

C. Electric Transmission and Distribution Service

1. Unbundling Other Customer Services

(a) Introduction

Several of the parties to the restructuring proceeding have either supported further unbundling in billing and metering or have argued that further exploration of these issues not be foreclosed by decisions in this proceeding. The OCA has made recommendations regarding metering, billing and other customer services to assure that options for competitive provision of

these services is not foreclosed. The OCA sets forth its specific recommendations below.

(b) Resolution in Generic Proceedings v. Resolution in this Case

The OCA recognizes that there are several generic proceedings at the Commission that could potentially resolve some of the issues presented here. However, it is important to address certain issues during this proceeding so that appropriate interim procedures are in place for the onset of competition, particularly since it appears that some of the generic rulemakings will not be completed by January 1, 1999. See also, OCA St. 5 at 30. As such, the OCA submits that certain issues must be resolved on an interim basis.

(c) Interim Rules Applicable to Duquesne -- See section (b) above.

(d) Specific Services

(i) Customer Billing

a. Supplier-Only Billing

The proposed billing options contained in Duquesne's initial filing did not conform to the Commission's July 11, 1997 Order on Maintaining Customer Service at the Same Level of Quality (Docket No. M-00960890 F0011). OCA St. 5 at 44. Of the three billing options that the Commission has mandated (single bill from the EDC for all charges, two bills - one from EDC, one from supplier, or a single bill from the supplier containing all charges), Duquesne has not included a supplier-issued total bill as an option. Duq. St. 8 at 10. The OCA submits that Duquesne has not presented a compelling reason for not complying with the Commission's Order and should be required to correct this in its compliance filing.

The OCA submits that Duquesne should be in the proper position to implement such a change, particularly since it is in the process of implementing the CARS system, a new automated metering system that would allow interface with alternative suppliers. Indeed, while on the stand, Duquesne witness Allison agreed that with the proper exchange of information, suppliers could provide a single bill for all customer charges. Tr. 878-880. As such, Duquesne should be directed to include this in its compliance filing.

b. Billing Complaint Resolution

The OCA is in general agreement with the Company's proposals regarding complaint resolution relating to billing. OCA St. 5 at 46. The OCA submits, however, that the Company failed in its initial filing to specifically address how a complaint would be handled for a supplier-only bill. OCA St. 5 at 46. Specifically, OCA witness Alexander, while recognizing that "Duquesne probably has no obligation to handle disputes relating to supplier charges when the supplier has billed the customer directly," recommended that in the case of a dispute effecting both the Supplier and EDC (i.e. a meter reading dispute) the EDC "own" the complaint. OCA St. 5 at 46. She urged the PUC to require Duquesne to provide protocol to address the joint EDC/Supplier dispute. OCA St. 5 at 46-47; see also Order Maintaining Customer Service at the Same Level of Quality at 7-8, 33. The OCA submits that Duquesne should provide these procedures as part of its compliance filing for review by all parties and the Commission.

c. Billing Format

Duquesne provided two bill formats with its filing--one showing a bill for both delivery and generation service and one for delivery service alone. Filing Requirement P.13. OCA witness Alexander reviewed Duquesne's proposed bill formats and recommended several changes to the formats. In summary, these changes include: a) the bill should identify regulated versus competitive services; b) the bill should provide additional room for supplier information and generation materials with information presented in the same manner regardless of the supplier; c) the bill should include a uniform method of disclosing prices such as the per kWh charge for T&D and generation for residential customers; d) the proposed bill format should use plain language and not include an unnecesary number of elements; e) the outside supplier should be allowed to include its own billing page in the Duquesne provided bill; and f) the bill should include disclosure on fuel sources. OCA St. 5 at 31-34. The OCA submits that Duquesne should be directed to provide revised bill formats in its compliance filing that reflect these proposals.

(ii) Metering

Upon review of Duquesne's filing, OCA witness Alexander noted that the Company is opposed to unbundling the metering function. OCA St. 5 at 40. At the same time, Duquesne is in the process of significantly upgrading its metering capability with the CARS system, installed by Itron, Inc. As Ms. Alexander explains:

> This system will allow automated communications of the customer's usage and power reliability data via an electronic communications link. As a result of this installation, which Duquesne proposes to be paid for by current customers in the distribution charges, the Company will position itself with a tremendous advantage in marketing electricity and electric services should it choose to do so in the future or if the merger with Allegheny Power is approved.

OCA St. 5 at 41.

Indeed, as OCA witness Alexander notes, while the Company recognizes that a customer may have an alternate meter installed, Duquesne will not unbundle any part of its current metering costs. Ms. Alexander states that "this approach is unnecessarily narrow, even at this initial stage of the exploration of the concept of increased competition for meters and meter services." OCA St. 5 at 41. Therefore, OCA witness Alexander makes the following recommendations: (1) Duquesne's short term policies should be compatible with the possibility of increased competition in metering and metering services; (2) Open architecture standards should be developed by the stakeholders and approved by the Commission; (3) Duquesne should be prepared to unbundle the current cost of some features associated with metering and provide a credit to any customer who obtains an alternative meter or whose meter is electronically read by a supplier; (4) Duquesne should be prepared for installation and billing for alternate meters by suppliers; (5) Standard load profiles used for low use residential and small commercial customers should be updated frequently and approved by the Commission; and (6) Duquesne has not proposed any charges to provide usage or billing information to suppliers for access to customer-specific usage information, therefore none should be imposed. OCA St. 5 at 41-44. The OCA requests that the Commission adopt these recommendations.

(e) Conclusion

During the transition to competition, the establishment of consumer protection standards and the fostering of competitive services is important to the development of a robust retail market. The OCA submits that OCA witness Alexander has provided persuasive testimony on many of these key issues, and respectfully requests that her recommendations be adopted.

2. Agency

As part of its direct case, Enron proposed a Supplier Complete Bill Option that would create an agency relationship between the customer and Enron, such that Enron could obtain all of the necessary services on the customer's behalf and provide a single bill for these services. OCA witness Alexander identified several concerns with Enron's proposal, particularly with regard to consumer protection issues. These concerns are discussed in Ms. Alexander's rebuttal testimony. OCA St. 5R at 7-9. For these reasons, the OCA submits that Enron's proposal raises significant concerns that must be thoroughly explored before approval.

3. Other Issues (e.g., CARS system) -- See above.

D. Consumer Protection and Service Issues

1. Termination

In its filing, Duquesne's procedures regarding termination of a customer from the electricity grid for non-payment of charges were unclear. In the Order concerning Licensing Requirements for Electric Generation Suppliers, Docket No. M-00960890 F004 (Order entered February 13, 1997), the Commission stated that an EDC could not terminate a customer for failure to pay an alternative supplier's charges. During cross-examination, Duquesne witness Hoffman affirmed that Duquesne will not terminate under these circumstances. Tr. 1010. See OCA Cross-Ex. Exh. No. 9. The OCA submits that this is consistent with the Commission's Order and Duquesne's compliance filing should clearly set forth its procedures.

Similarly, Duquesne should not be permitted to condition restoration or reconnection of service on the payment of past-due supplier charges, unless those charges are owed to the customer's supplier of last resort. OCA St. 5 at 52; Order on Maintaining Customer Services at the

Same Level of Quality at 45.

2. Switching

a. Fees

The OCA notes that the Company has raised an issue concerning additional charges in its rebuttal testimony that needs to be addressed. In direct testimony, the Company gave no indication of any additional fees to be charged associated with a customer's service. However, in rebuttal testimony, Duquesne witness Allison stated that, "Duquesne will charge customers and/or suppliers the "net incremental cost" of providing such services as: changing a customer's supplier of record, supplier settlement, customized billing, collection activities, customer payment processing, customer service, and other potential charges as well. During this proceeding, Duquesne has made no quantification of what these charges will be, or what their amount will be. Duquesne St. 8-R at 19-20. Therefore, the OCA has no way of evaluating whether such charges are justified or reasonable. OCA witness Alexander explains that this is inappropriate. She explains:

> This is the restructuring proceeding that should address the Company's procedures, tariff changes and fees, if any, associated with the move to retail electric competition. It is unreasonable to suggest, as does Mr. Allison, that fees and charges for a specified list of services will be charged at "net incremental cost" without Commission review. It is the Company's responsibility to unbundle its services and allow the Commission to determine whether fees should be charged and in what amount in this proceeding.

OCA St. 5S at 16. The OCA submits that this proceeding was the proper forum to evaluate the need for such additional fees. Duquesne has not presented any quantification or qualification, and should not be permitted to implement such charges, without proper review and justification.

b. Change of Supplier

Regarding a customer's change of supplier, the Company has proposed Tariff Rule 27, which allows for a change of supplier based on either oral or written confirmation from the customer, but does not allow the supplier to contact Duquesne on behalf of the customer without written proof of authorization. OCA St. 5 at 38. OCA witness Alexander distinguished between customer-initiated changes and marketer-initiated changes. She recommends that:

> The Commission should allow customers to inform the distribution company directly of the identity of their preferred supplier as proposed by Duquesne Light and allow as well a supplier to notify the distribution company of the customer's selection as long as the customer's selection was either in writing or verified by an independent third party, or if accomplished via contact initiated by a marketer or supplier, accompanied by written authorization. However, if the customer initiates the contact, the requirement of a signature or the creation of an additional hurdle by requiring that the customer communicate directly with the distribution company is not reasonable.

OCA St. 5 at 38-39.

The OCA also submits that the Company's proposed 5-day notice to switch suppliers is reasonable, but the requirement of a physical meter reading should not be necessary if a customer agrees to a prorated bill for the billing period. OCA St. 5 at 39-40. The OCA requests that these proposals be adopted.

E. Partial Payments

The Company has committed to apply customer payments "in the consolidated bill scenario consistent with the Guidelines for Maintaining Customer Services...", thus implementing the partial payment procedures in the Commission's Order. Duq. St. 8-R at 24. The OCA believes that this resolves this issue.

X. UNIVERSAL SERVICE AND ENERGY CONSERVATION

A. Introduction

Under traditional regulation, certain programs were created to address the Commission's and utilities' concern to effectively provide utility services to low income customers. Historically, such programs as the Customer Assistance Program (CAP) and the Low Income Usage Reduction Program (LIURP) have attempted to serve this need. These programs have traditionally been administered by the jurisdictional utility, with the assistance of community based organizations. With the advent of competition in the electric industry, the Pennsylvania General Assembly recognized the importance of ensuring that such universal service programs continue to be available to Pennsylvania's low-income ratepayers.

Specifically, Section 2804(9) of the Electric Generation Customer Choice and Competition

Act ("Act") provides that: "The commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution territory." 66 Pa.C.S. §2804(9). Under the Act, "Universal Service" is defined as:

> Policies, protections and services that help low-income customers to maintain electric service. The term includes customer assistance programs, termination of service protection and policies and services that help low-income customers to reduce or manage energy consumption in a cost-effective manner, such as the low income usage reduction programs, application of renewable resources and consumer education.

66 Pa.C.S. §2803. To carry out this purpose, the Act requires that "at a minimum" universal service and energy conservation programs continue at current levels. 66 Pa.C.S. §2802(10).

CAAP witness Wilson also expressed a concern for low income customers during competition, stating:

> Low income customers are not likely to share in the benefits of a restructured industry. In fact, they may be substantially harmed by it unless strong and meaningful programs and policies are put into place to protect them. Low income customers are perhaps the most captive of customers. As such, their ability to exercise choice in generation as the industry restructures will be less than other residential customers.

CAAP St. 1 at 2-3.

Duquesne currently provides a pilot Customer Assistance Program (CAP) and Smart Comfort, a Low Income Usage Reduction Program (LIURP). Pursuant to the mandate of the Act, Duquesne filed a preliminary universal service plan as part of its Restructuring Filing. This was then supplemented by the submission of a more comprehensive Universal Service plan on November 3, 1997, which took into account the Commission's July 11, 1997 Order. This plan contained (a) a description of applicable legislative and regulatory requirements, (b) an overview of Duquesne's universal service and energy conservation goals, (c) a detailed itemization of Duquesne's existing policies, (d) Duquesne's proposed response to three new requirements necessitated by the unbundling of service elements and the introduction of competition, (e) a universal service needs assessment, (f) a review of current universal service and energy conservation expenditures, (g) a

description of proposed universal service and energy conservation programs operations, (h) program delivery mechanism proposals, (i) cost recovery proposals, and (j) proposals on reporting, evaluation, and advisory panels. OCA St. 6 at 10-11. Duquesne has also identified a number of other methods of addressing universal service in its Plan. Duq. Exh. JPF-1 at 9. These potentially include matching programs to more rapidly reduce a customer's arrearage, and creative payment arrangements to recognize temporary hardships. Id. Duquesne has also indicated that it "may choose to explore alternate metering or usage control devices". Id.

The OCA has reviewed and evaluated Duquesne's proposed Universal Service and Energy Conservation plan and finds that while Duquesne's approach is innovative and has made impacts in some areas, overall, it lacks certain necessary elements to ensure that it will be operated in a manner that meets the objectives of the Act and the Commission's Order.

OCA witness Brockway[12] expressed concern about the Company's approach. She stated: "[w]hile Duquesne's holistic approach is commendable, the Duquesne plan does not contain adequate assurances that it will be operated in such a way as to meet the objectives of the statute and the Commission's Final Order on Universal Service and Energy Conservation." OCA St. 6 at 13. Ms. Brockway identified three general reasons why the Company's approach is risky for low-income customers and the Commission. OCA St. 6 at 14. She explains:

> *First*, the Company does not match its commitment to tailored customer services with an adequate budget commitment. *Second*, the failure to adopt target enrollment and benefit amounts leaves too much uncertainty about actual levels of CAP service under the Plan. *Third*, some of the concepts for "additional services" proposed in the Plan sound like punitive or counterproductive measures that degrade the quality of service a participant receives.

OCA St. 6 at 14 (emphasis in original).

Additionally, OCA witness Brockway raised an important issue regarding the company's proposal to explore alternate metering or usage control devices:

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[12] OCA witness Nancy Brockway's qualifications are set forth in OCA Exh. NB-Duquesne-1.

> The description of these possible "service" additions is cryptic, and so it is possible that they represent advances in thinking on how to accomplish universal service. However, ...alternate metering and usage control devices sounds like a possible reference to prepayment metering and service limiters. Neither prepayment meters nor service limiters are sound measures to use as universal service tools in the homes of low-income customers. In both cases, a low-income customer is at risk of loss of service without advance warning in person by Company or CAP program personnel. ... The devices avoid the problem of determining the nature of the underlying problem that has caused the household to fall into arrears. They also remove the Company's incentive to address the underlying problem.

OCA St. 6 at 19-20.

As set forth below, in addition to the OCA's concerns regarding Duquesne's Universal Service and Energy Conservation Plan, the OCA has found that Duquesne's existing programs require certain modifications, as well as expansion in both eligibility requirements and funding levels.

The OCA submits that Duquesne be required to modify its Universal Service plan to adequately address the needs of its low-income customers, consistent with the testimony of OCA witness Brockway and the reasons stated below.

B. Overall Funding and Rate Issues

1. Eligibility

The Company uses a very narrow definition of eligibility for its CAP program -- one that requires a customer to be delinquent in their bills before being eligible for the program. OCA St. 6 at 33. Although the OCA agrees that it may make sense to target CAP benefit dollars to the most at-risk customers, passing a payment-trouble screen should not be an absolute requirement. OCA St. 6 at 34. As explained below, the Company's eligibility criteria are too limited to meet the needs of the low-income community and ensure that the goals of the Act are met.

OCA witness Brockway recommends that Duquesne broaden its eligibility criteria to include non-delinquent, high-risk customers, consistent with PP&L's proposal to extend eligibility to customers who are at risk of not being able to maintain service. OCA St. 6 at 35. She states, "I have endorsed this concept, and recommend that the list suggested by PP&L, with two narrow additions I have proposed, be used by Duquesne to enable a more complete group of at-risk

customers to qualify for CAP assistance." OCA St. 6 at 35. This list includes:

- Injury or illness of primary wage earner,
- High medical bills,
- Loss of job or other reduction in income,
- Abandoned spouse with young children,
- Very low income elderly,
- Very low-income households with children under school age, and
- Very low-income households with a permanently disabled person residing in the house and requiring personal care for daily living.

OCA St. 6 at 36. Ms. Brockway describes the reasons for these groups as such: "Taken together, these categories describe households where the adult(s) are unable to take on jobs outside the house to increase the family income sufficiently to afford service, and are locked into their very low-income situation so long as these constraints persist." OCA St. 6 at 36.

The OCA submits that this expansion of eligibility is particularly important due to the high burden of low-income customers in meeting their electric bills in Duquesne's service territory. Ms. Brockway explained:

> For example, today, the median family income in the Duquesne service area spends about 2.8% of its income on electricity in the case of a general use customer, and 4.3% in the case of a customer who heats with electricity. By contrast, low income families without electric space heat can spend as much as 25% of their income on electricity, and those with space heat can spend almost 38% of their income for electricity. These high burdens are a function of the level of income and the typical bills of such customers.

OCA St. 6 at 26. Ms. Brockway went on to note that even customers in the income range of 100-150% of poverty carry twice the payment burden as median income customers on average. Id. Moreover, in the last three years, Duquesne has disconnected 22,464 accounts with an average length of time without electricity being over one month. OCA St. 6 at 21.

Despite this need, Duquesne has not set any specific targets for customer enrollment in its universal service programs, even though its own estimates show a need to expand services beyond the current levels. OCA St. 6 at 18. OCA witness Brockway recommended that the Company make reasonable efforts to achieve a 50% participation rate of the eligible households. While Ms. Brockway estimated the number of low-income customers in need of assistance to be as high as

117,000, she said the number who fall into the core group contemplated by the Commission in its Final Order on Universal Service is between 25,000 and 34,000 households. OCA St. 6 at 32. As such, the OCA submits that it is a reasonable recommendation to require that Duquesne set a goal for its CAP program of providing bill assistance to 24,000 eligible customers by the end of three years.

2. Funding Levels for CAP and LIURP

Duquesne has proposed that its Universal Service budget be set equal to its current universal service spending. This suggests a CAP budget of $550,000. The OCA submits that this level of funding does not meet the need of Duquesne's service territory. To provide assistance to the OCA's recommended level of eligible customers, the OCA recognizes that Duquesne's budget may have to be increased. OCA witness Brockway proposed a budget of 0.5% of gross revenues or $5,725,000. OCA St. 6 at 32-33. The amount would serve the targeted goal of 24,000 participants.

In considering funding for the Low Income Usage Reduction Program ("LIURP") contained in Duquesne's filing (Smart Comfort), OCA witness Brockway noted that the Company's budget for its LIURP program of $700,000 per year currently consists of between 0.06% and 0.07% of the Company's gross operating revenues. OCA St. 6 at 42. She recommends that Duquesne ramp up the funding for the LIURP program to 0.2% of its gross operating revenues, or approximately $2.2 million, over four years. Id. While Ms. Brockway acknowledges the value of the individual approach to usage reduction that Duquesne has taken, she also recognizes that there are many more customers who could benefit from these services. She states:

> A ramp-up such as that I propose need not interfere with the Company's proposal to tailor universal service approaches to individual clients. While the Company has not performed a needs assessment for LIURP services, it has provided its comprehensive services so far to 6,000 low-income customers. As there are upwards of 117,000 low-income households in the service area, and as many as 25,000 to 35,000 payment-troubled low-income households, even a faster ramp-up would take many years to provide services to all low-income households.

OCA St. 6 at 42-43. However, Ms. Brockway has recognized that care should be taken not to jeopardize the successful qualities of Duquesne's program, due to a speedy ramp-up. OCA St. 6

at 43. She explains that, "Ramping up too soon, and ramping up beyond the capacity to maintain the hands-on involvement of current managers, would jeopardize the intangible qualities that make Smart Comfort successful." Id.

For the reasons set forth above and in the testimony of OCA witness Brockway, the OCA recommends that the Company be directed to increase its funding for its CAP and LIURP programs.

3. Cost Allocation and Rate Design

In its filing, the Company has proposed to recover its universal service costs through a non-bypassable per-kilowatthour charge assessed on all distribution customers. Duq. Exh. JPF-1 at 9. The charge would vary based on the allocated distribution costs for each customer class. Id.

In evaluating the Company's proposal, OCA witness Brockway found that:

> In the Commission's decision in the Universal Service docket, the Commission stated that all customers should support universal service costs, but a per-kWh charge should not be used as the allocator for such costs. However, since the Company's proposed allocator is relative distribution costs, and not energy, the fact that the Company proposes a kWh charge as the rate design to collect class allocated universal service charges would appear not to be inconsistent with the Commission's directives in the *Final Order.*

OCA St. 6 at 48-49.

The OCA submits that Duquesne's universal service costs should be recovered from all customers on an equitable basis, and recommends that the Commission adopt an allocation of universal service costs which ensures that all customer classes contribute to universal service funding in an equitable fashion. OCA witness Brockway recommended that universal service costs be assessed to all customer classes on a per kilowatt hour basis. OCA St. 6 at 52.

In the event that the Commission rejects the use of a per kilowatt hour basis for allocation of universal service costs, the OCA recommends use of Ms. Brockway's non-production revenue allocator. OCA St. 6 at 50-51; OCA Exh. NB-Duquesne-4. This allocator focuses on the regulated, non-production related costs. By doing so, the method imposes a higher allocation of universal service costs on residential customers than the per kilowatthour basis. For example, the non-production allocator produces an allocation to the residential classes of 44.8% of the universal

service costs as opposed to 26.8% using the kWh allocator. OCA St. 6 at 51.

While the OCA recognizes that the Commission in the PECO case allocated all universal service costs to residential customers, the OCA respectfully submits that such a determination would not be appropriate in this case. Allocating universal service costs to the residential class only allows other customers to bypass this cost. This was not the General Assembly's intent in that it provided for the recovery of these costs through a non-bypassable mechanism. 66 Pa.C.S. §2804(9).

In addition, in PECO, the Commission was concerned with cost-shifting of the Company's substantial costs that had previously been allocated to residential customers. The Commission believed that any change in the allocation would create cost shifting. While the OCA respectfully disagrees with the Commission's PECO decision on this point, the OCA would note that in PECO, the Commission was addressing existing costs for existing programs that had been previously allocated to residential customers. Here, however, the OCA submits that the costs of Duquesne's expanded programs – i.e., new costs -- presents a different issue. As such, these costs should be allocated to all customers.

Moreover, Mr. Baron's and Mr. Kalcic's arguments that the rate cap and ratemaking principles require allocation of these costs to residential customers are without merit. First, as OCA witness Brockway explained, the suggestion that allocation of these costs to all customers would violate the rate cap are overstated. The rate cap requires that total charges, both generation and non-generation, do not exceed the level in effect on January 1, 1997. OCA St. 6S at 13-15. These rate caps do not require a specific allocation of costs.

As to arguments regarding cost causation principles, these arguments prove too much. Mr. Baron argues that ratemaking principles require these costs to be paid by the customers causing the costs. DII St. 1R at 4-5. As Ms. Brockway explained, taking this to its logical conclusion would mean that all universal service costs would be assigned to universal service recipients, thus eliminating all benefits. OCA St. 6S at 15-16. Additionally, this argument ignores the benefits to the system as a whole that flow from such programs. Ms. Brockway noted that these benefits include (a) economic

stability, (b) secure and stable neighborhoods and (c) better public health and safety. OCA St. 6S at 16-17.

For these reasons, the OCA submits that the OCA's proposed allocation of universal service costs be adopted in this proceeding.

C. Specific Programs

Duquesne currently offers two programs to provide assistance to its low-income customers. These are the Customer Assistance Program (CAP) and the Low Income Usage Reduction Program (LIURP). OCA witness Brockway reviewed the proposals contained in Duquesne's filings to evaluate their compliance with the mandates contained in the Act and the orders that the Commission has issued on universal service. Her comments on Duquesne's individual programs, contained in OCA St. 6 and 6S, are summarized below.

1. CAP Program

The OCA submits that Duquesne's CAP program requires modification in certain areas to meet the elements of a successful CAP program set forth in OCA witness Brockway's testimony at pages 29-38 and to effectively promote the goal of universal service. First, Duquesne uses a tiered structure for determining the maximum copayment for a CAP participant. While the OCA supports the concept of a tiered structure for the maximum copayment for CAP participants, Duquesne makes no distinction between heating and non-heating customers. As such, for general use customers, customers at the higher tiers are subject to a burden greater than the 5% of income that OCA witness Brockway recommends as the maximum, and residential heat customers are below Ms. Brockway's recommended 8% of income. OCA St. 6 at 29. The OCA submits that, consistent with the recommendations of OCA witness Brockway, Duquesne keep the current matrix for space heat customers and create a separate and lower set of burden guidelines for its general use CAP customers. OCA St. 6 at 29-30. The maximum burdens by tier would be as follows: (1) 0-50% : 4%; (2) 51-100% : 6%; (3) over 100% : 8%. Id.

Second, as discussed in the Eligibility section, Duquesne's program should be expanded and

target a 50% participation rate.

Third, as discussed above, OCA witness Brockway explains that the Company's program guidelines create unnecessary barriers to eligibility and contain unnecessary limitations on program participation. OCA St. 6 at 33-34. Ms. Brockway explains:

> *It does make sense to target CAP benefit dollars to the most at-risk customers.* The Company goes too far, however, in screening out customers who are at risk of falling behind on their bills and losing service. The Company uses two indicia of payment-trouble to screen potential CAP participants: past-due balance of at least $500, and housing expenses exceeding 45% of the household income. Apparently, a customer must pass both payment-trouble screens to qualify under Duquesne's CAP. Only one payment-trouble screen is needed to ensure proper targeting of CAP benefits.

OCA St. 6 at 34.

OCA witness Brockway continues by explaining that both of the screens used by Duquesne are too limited for a universal service program. The requirement of a $500 past due balance could set up a situation where customers are encouraged to allow their bills to reach that level in order to qualify for the assistance. OCA St. 6 at 34. The requirement that household expenses exceed 45% of household income is an extremely high threshold, especially when HUD guidelines consider unaffordable housing to be in excess of 30% of income. OCA St. 6 at 34-35. Further, such detailed screening may require the Company to incur unnecessary administrative costs, given the specificity of information required to determine eligibility. OCA St. 6 at 35. OCA witness Brockway recommends that the Company rely more on a modified arrearage screen to target potential enrollees, as it is more readily identifiable and less cumbersome and expensive than the "excess housing cost" screen. OCA St. 6 at 35.

Fourth, OCA witness Brockway suggests reducing the flat $5/month payment towards customer arrerages to $3/month for those customers in the lower tiers of the federal poverty level. OCA St. 6 at 37.

Fifth, Ms. Brockway recommends that Duquesne be required to implement a more detailed evaluation plan than the Company has proposed. This is necessary due to the existence of the CAP pilot and Duquesne's approach to universal service issues. OCA St. 6 at 38.

Finally, the low income benefits should be made portable so low income customers enjoy the same choice of suppliers as other customers. OCA St. 6 at 36.

While OCA witness Brockway found that Duquesne's universal service program has a "sound basic design", she also enumerated a number of concerns with the program set forth above. Among her concerns are the size and funding for the CAP program, the customer eligibility requirements, and the need for a comprehensive evaluation. Each of Ms. Brockway's suggestions will strengthen Duquesne's universal service program to the benefit of not only Duquesne's low-income customers, but all ratepayers. Therefore, the OCA submits that Duquesne be directed to incorporate the recommendations of OCA witness Brockway as part of its Customer Assistance Program.

2. LIURP

OCA witness Brockway also reviewed the Low Income Usage Reduction Program ("LIURP") component of Duquesne's universal service plan. Duquesne's LIURP program primarily addresses baseload uses and is delivered free to eligible customers, those with incomes below 150% of federal poverty guidelines. OCA St. 6 at 41. The Company budgets $700,000 per year for this program, but its spending has varied. The program is delivered by community-based organizations in Duquesne's service territory. Specific recommendations regarding LIURP funding levels are addressed above.

3. Renewables

In addition to the Company's successful LIURP initiatives, the OCA also recommends that Duquesne implement a renewables pilot program. In the OCA's direct testimony, OCA witness Brockway identified the elements of a renewables pilot program to be incorporated into Duquesne's universal service program as follows:

- Issuing an RFP to solicit proposals to install 10 units of photovoltaic ("PV") electricity panels at 1 kW in 1999, and 20 units of PV in 2000, on the dwellings of low-income customers.
- Seeking bids in a price range of $5.00 per watt.
- Seeking proposals to install up to $50,000 worth of passive or active solar hot water heating.
- Requiring a diversity of building types, locations, land tenancies, sizes and metering arrangements.

- Conducting a process and impact evaluation of the installations, capturing such features as customer acceptance of the measures, landlord acceptance in the case where the customer is a renter, cost per unit, payback per unit, Total Resource Cost on a present value basis per unit, and the like.
- Involving the Universal Service Advisory Committee during pilot development and evaluation.
- Submitting a report to the PUC in 1999 and 2000 regarding the pilot's status and findings, together with recommendations regarding extending or renewing the pilot.

OCA St. 6 at 43-47.

OCA witness Brockway identified a number of reasons that the pilot should be implemented. OCA St. 6 at 46. First, the inclusion of renewables in the language of the Act relating to universal service and energy conservation demonstrates the General Assembly's interest in testing the viability of renewable generation in this context. OCA St. 6 at 46. Second, PV power addresses not only environmental concerns, but also can help reduce the cost of distribution upgrades by delaying or alleviating their need. OCA St. 6 at 46. This is especially true in densely packed urban areas, such as Duquesne's service territory. Third, PV power requires low maintenance, and very little customer/machine interaction to provide its benefits. OCA St. 6 at 46.

Additionally, it should be noted that in the PECO Order, the Commission directed that a renewables pilot be included, consistent with OCA witness Brockway's recommendation. PECO Order at 147. The OCA submits that for the reasons stated above, Duquesne should be directed to include a renewables pilot, such as the PV pilot contained in OCA witness Brockway's testimony, as part of its universal service plan.

D. Energy Conservation -- For discussion on this issue, see LIURP section.

XI. CUSTOMER EDUCATION

A. Scope of Customer Education

1. State-Wide v. Company Specific

In the recent PECO Order, the Commission directed implementation of a state-wide program for consumer education. The Commission recognized the value of a statewide approach to

consumer education, finding that in addition to geographic reasons, such an approach would lower the costs for all EDCs, due to economies of scale; will address consumer education on a statewide basis; and that "a statewide approach...insures a consistent, honest and competitively neutral approach to consumer education." PECO Order at 152. In order to implement this directive, the Commission has created a committee to address the statewide campaign. Most recently, the Commission initiated a separate proceeding to address the formation of this committee.[13]

The OCA fully supports the Commission's statewide approach to consumer education and submits that a statewide consumer education plan coupled with a local effort coordinated by Duquesne is the best method of ensuring that Duquesne's customers receive the knowledge that will allow them to make educated choices as we enter into full retail access, and also accomplish the educational goals of the General Assembly and the Commission. The Commission's initiative is consistent with the OCA's testimony in this proceeding. See, OCA St. 5 at 20-23. As such, the OCA submits that Duquesne should be directed to participate in the state-wide program.

2. Role of EDC

In the PECO Order, the Commission also recognized that the existence of a statewide plan does not exonerate the local EDC from all of its consumer education obligations. PECO Order at 155. The Commission elaborated that each company still has obligations associated with "plain language, direct mail and bill insert communications to consumers, customer services, low income education, training of personnel to answer questions from the public, participation in education policy issues and keeping this Commission informed of issues, problems and successes in their educational efforts." PECO Order at 155. OCA witness Alexander also testified to the important role of the EDC in this effort. Ms. Alexander explained:

> The role of the distribution company's own program will be to provide customers with the utility-specific information such as the specific nature of the pilot programs in their

[13] 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.

service territory, prices for distribution services, format of the distribution company bill, how to select a supplier, and how and where to contact the utility for further information (get copies of brochures, handbooks, etc.).

OCA St. 5 at 23.

In light of the role of the EDC, Ms. Alexander reviewed Duquesne's plan and noted a number of deficiencies. OCA St. 5 at 5. Overall, she stated that Duquesne had not proposed a plan, and omitted a great deal of substantive information on the objectives, goals, and budget for consumer education. Id. The specific deficiencies in the Company's filing identified by Ms. Alexander are:

- There is no suggestion in the Company's materials or proposals that customers may need to be motivated to learn and read the materials associated with the development of a competitive market.
- Duquesne Light has not conducted extensive customer research to determine what information its customers already know and what they would like to know about electric competition. The Company's research to date merely tests customer awareness of electric competition. Its customer focus groups only explored customer reaction to Company materials and seemed more interested in exploring the customer's reaction to the Company's image after reviewing the draft materials.
- The Company's proposal does not have any time lines or interim goals and objectives to determine whether the program is achieving its objectives.
- The plan fails to identify or describe the development of information targeted to particular customer groups or how the Company will work with community-based organizations and other grass roots efforts to target educational information to low income customers and others who may have a heightened concern with the risks associated with electric competition, such as the elderly.
- The Company promises evaluation, but does not describe how and when this will occur.
- The Company's communications with its customers and its educational materials published in 1997 emphasize the role of Duquesne Light Company in the new market structure and are more in the nature of image advertising.
- The materials developed for the Pilot Program are confusing and not adequate to assist customers in learning to shop for their electricity supplier.
- The Company does not propose a budget for its educational initiatives beyond 1997.

OCA St. 5 at 5-6. Ms. Alexander explains that Duquesne's proposed customer education plan does not comply with the requirements of the Act, as there are too many important details missing. OCA St. 5 at 7. While Duquesne has proposed a list of outreach vehicles to employ, there is no overall

theme to link these materials. Id. Moreover, much of the Company's effort to date has been directed at bolstering the Company's image through "advertorials" rather than providing objective consumer education. OCA St. 5 at 13-14. OCA witness Alexander concluded that "the Company has approached its obligation very narrowly and has not devised a consumer education plan to stimulate consumer interest and involvement in choosing an electricity supplier." OCA St. 5 at 7.

The OCA submits that Duquesne should be directed to coordinate its education efforts with the statewide program. In addition, the Company should be directed to provide a detailed plan with its compliance filing.

B. Implementation Issues

OCA witness Alexander recommended that Duquesne should work closely with Community Based Organizations (CBOs), representatives of vulnerable populations and consumer organizations in the design and implementation of the Company's consumer education plan. OCA St. 5 at 17. This will allow Duquesne to obtain "insight into local information needs and methods of interaction and communication that will be successful." Id. In rebuttal, Duquesne endorsed the involvement of CBOs, but did not demonstrate how they would be involved. OCA St. 5S at 6. OCA witness Alexander explains that this is important because "it is more likely that low income customers will learn more effectively about electric competition through their local community organizations than through a reliance solely on bill inserts or newspaper advertisements." OCA St. 5 at 7. CAAP witness Wilson echoed these concerns. CAAP St. 1 at 7.

The OCA submits that pursuant to Ms. Alexander's recommendations, Duquesne be directed to include involvement with CBOs as part of its consumer education program.

C. Funding Levels and Recovery

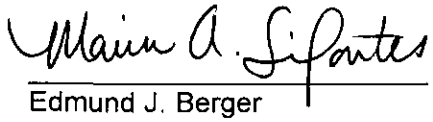
The OCA does not dispute that reasonable consumer education funding should be recovered from ratepayers. At this time, however, the Company has not provided a budget or a detailed Consumer Education Plan upon which such decisions can be made. The Company should be directed to provide a budget and a detailed plan in its compliance filing.

XII. MISCELLANEOUS ISSUES--Not applicable to OCA

XIII. CONCLUSION

WHEREFORE, OCA respectfully submits that the OCA's recommended modifications to Duquesne Light Company's restructuring plan be adopted.

Respectfully submitted,



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Dated: February 9, 1998
45722

DUQUESNE LIGHT COMPANY

SUMMARY OF
STRANDED COSTS[1]
(millions $)

	Company Claim	OCA Adjustments	OCA Adjusted Amount
Nuclear	$ 934.40	$(92.15)	$842.25
Fossil	607.29	(429.23)	178.06
Fossil + Nuclear Subtotal	$1,541.69	(521.38)	1,020.31
Regulatory Assets	357.28	(26.44)	330.84
Total Net Present Value (NPV) in 1999 $	$1,898.97	$(547.82)	$1,351.15[2]
PUC Jurisdictional Percent	99.9%	--	99.9%

(1) All figures are net of tax.
(2) OCA results are pre-merger and should be reduced by $152.28 if merger is completed.
(3) See subsequent tables for sources.

DUQUESNE LIGHT COMPANY

STRANDED COSTS
CALCULATION-FOSSIL + NUCLEAR
(millions $)

	Company Claim[1]	OCA Adjustments	OCA Adjusted Amount
a. Net Book Value	$1,236.96	$ 37.94	$1,274.91[2]
b. (Market Value)	(27.40)	(271.67)	(299.07)[3],[4]
c. PV of Fossil + Nuclear Decommissioning	123.90	(79.43)	44.47[2]
d. PV of Costs Independent of Operation	208.23	(208.23)	0.00
e. Net Present Value (NPV) in 1999 $ (a+b+c+d)	$1,541.69	$(521.38)	$1,020.31[4]
Discount Rate	7.83%		6.88%
PUC Jurisdictional Percent	99.9%		99.9%

(1) Source: Exhibit No. DJC-10.

(2) Source: OCA Statement No. 1A, Schedule MIK-1, page 2 of 3, December 1997 update. The net book value figure on that schedule of $1,487.91 is adjusted downward in order to express the Beaver Valley 2 lease on a net of tax basis (a reduction of $213 million) to be consistent with Duquesne's presentation.

(3) Source: OCA Statement No. 1A, Schedule MIK-1, pp. 2 and 3, December 1997 update. Market value is $115.31 on page 2, plus $13.04 (productivity adjustment) and $170.72 (life extension) on page 3.

(4) If merger is completed, figures should be further reduced by $152.28. Source: same as note (3).

(5) All figures are net of tax.

DUQUESNE LIGHT COMPANY

STRANDED COSTS
CALCULATION-NUCLEAR[1]
(millions $)

	Company Claim[2]	OCA Adjustments	OCA Adjusted Amount[3]
a. Net Book Value	$788.59	+$9.19	$797.78
b. (Market Value)	(7.20)	+7.20	0.00
c. PV of Nuclear Decommissioning	57.40	(12.93)	44.47
d. PV of Costs Independent of Operation	95.61	(95.61)	0.00
e. Net Present Value (NPV) in 1999$ (a+b+c+d)	$934.40	$(92.15)	$842.25
Discount Rate	7.83%		6.88%
PUC Jurisdictional Percent	99.9%		99.9%

(1) All figures are net of tax.
(2) Figures supplied by DLC to the parties.
(3) Source: OCA Statement No. 1A, Schedule MIK-1, page 2 of 3, December 1997 update. To be consistent with the Company presentation, the Beaver Valley 2 lease is expressed on a net of tax basis, a reduction of $213.0 million.

DUQUESNE LIGHT COMPANY

STRANDED COSTS
CALCULATION-FOSSIL[1]
(millions $)

	Company Claim[2]	OCA Adjustments	OCA Adjusted Amount[3]
a. Net Book Value	$448.37	+$28.76	$477.13
b. (Market Value)	(20.20)	(278.87)	(299.07)
c. PV of Fossil Decommissioning	66.50	(66.50)	0.00
d. PV of Costs Independent of Operation	112.62	(112.62)	0.00
e. Net Present Value (NPV) in 1999$ (a+b+c+d)	$607.29	(429.23)	$178.06
Discount Rate	7.83%		6.88%
PUC Jurisdictional Percent	99.9%		99.9%

(1) All figures are net of tax.
(2) Figures are supplied by the Company to the parties.
(3) Source: OCA Statement No. 1A, Schedule MIK-1, pp. 2 and 3, December 1997 update. Market value is the sum of figures on page 2 plus the productivity adjustment and life extension on page 3. These figures do not include merger savings ($152.28 million), which must be included if merger is completed.

DUQUESNE LIGHT COMPANY

STRANDED COST CALCULATION
REGULATORY ASSETS
($000)

		Company Claim (1)		OCA Adjustments		OCA Recommendation(2)	
		Gross	Net of Tax	Gross	Net of Tax	Gross	Net of Tax
a.	Regulatory Tax Receivable (SFAS 109)	$236,480	$179,000	$0	$0	$236,480	$179,000
b.	Post 2005 Unamortized Debt Costs	29,920	19,040	(580)	(370)	29,340	18,670
c.	Pre 2006 Unamortized Debt Costs	16,760	9,800	(330)	(190)	16,430	9,610
d.	Deferred Rate Synch. Costs	25,370	23,500	1,150	1,070	26,520	24,570
e.	Deferred Employee Costs	13,830	13,830	410	410	14,240	14,240
f.	Deferred Nuclear Mainteance	3,250	1,900	0	0	3,250	1,900
g.	DOE Decommissioning	5,580	3,250	160	100	5,740	3,350
h.	Deferred Coal Costs	13,500	13,500	(13,500)	(13,500)	0	0
i.	Deferred Caretaker Costs	6,770	3,920	(6,770)	(3,920)	0	0
j.	BV2 Training Costs	2,420	1,580	0	0	2,420	1,580
k.	Low Level Radioactive Waste	2,270	2,270	0	0	2,270	2,270
l.	Coal Cost Equalization	120	120	0	0	120	120
m.	Pre-Accrued Nuclear Outage Costs	17,600	10,290	(17,600)	(10,290)	0	0
n.	SFAS No. 106 Deferral	3,280	1,920	90	50	3,370	1,970
o.	Deferred Fuel Costs	11,510	6,730	330	190	11,840	6,920
p.	Other Regulatory Assets	530	530	0	0	530	530
q.	BV2 Sale/Leaseback Premium	N/A	N/A	0	0	N/A	N/A
r.	Gain on Sale Leaseback Tax Effect	55,130	55,130	0	0	55,130	55,130
s.	Deferred Rate Synch. Tax Effect	210	210	10	10	220	220
t.	Beaver Valley 2 Tax Effect	170	170	0	0	170	170
u.	SFAS No. 109 Plant	N/A	N/A	0	0	N/A	N/A
v.	Other Transition Expenses	18,100	10,590	0	0	18,100	10,590
w.	Total Regulatory Assets	$462,800	$357,280	($36,630)	($26,440)	$426,170	$330,840
	PUC Jurisdictional Percent		99.90%		99.90%		99.90%
	Deferred Taxes on Regulatory Assets		$105,520		($10,190)		$95,330

Notes:

(1) Amounts provided by Duquesne Light Company.

(2) Gross amounts per Schedule TSC-1, with Other Transition Expenses figure corrected to match revised Company claim. Net of tax amounts per Exhibit DJC-10.

Exhibit LS-7 Revised
(Revised LS-4)

Duquesne Light Company
Retail Cost of Service
$000

	1996	1999	2000	2001	2002	2003	2004	2005
Total Retail MWh	12,393,680	12,519,000	12,727,000	12,936,000	13,153,000	13,378,000	13,615,000	13,858,000
OCA Proposed Rates ¢/kWh:								
T&D	2.211	2.211	2.211	2.211	2.211	2.211	2.211	2.211
Market Generation		2.161	2.222	2.231	2.523	3.268	3.386	3.622
Generation A&G	0.368	0.368	0.378	0.389	0.400	0.412	0.425	0.440
Avoidable Generation Component		2.529	2.600	2.620	2.923	3.680	3.811	4.062
CTC		2.683	2.613	2.593	2.290	1.533	1.402	1.151
Total Proposed Rate		**7.423**	**7.423**	**7.423**	**7.423**	**7.423**	**7.423**	**7.423**
OCA Proposed Revenue:								
T&D	273,968	276,738	281,336	285,956	290,753	295,727	300,966	306,338
Market Generation		270,541	282,735	288,538	331,837	437,179	460,939	501,924
Generation A&G	45,648	46,110	48,104	50,322	52,614	55,125	57,930	60,922
Avoidable Generation Component		316,651	330,840	338,860	384,451	492,304	518,869	562,845
CTC		335,937	332,591	335,465	301,186	205,062	190,850	159,541
Total Proposed Revenue		**929,326**	**944,767**	**960,281**	**976,390**	**993,092**	**1,010,686**	**1,028,724**
Total Revenue @ Current Rates	1,106,787	**1,117,979**	**1,136,554**	**1,155,218**	**1,174,597**	**1,194,690**	**1,215,854**	**1,237,555**
Total Average Revenue ¢/kWh	8.930	8.930	8.930	8.930	8.930	8.930	8.930	8.930
Difference (Proposed - Current)		**(188,653)**	**(191,787)**	**(194,937)**	**(198,207)**	**(201,597)**	**(205,169)**	**(208,831)**
Percent Change From Current		-16.9%	-16.9%	-16.9%	-16.9%	-16.9%	-16.9%	-16.9%

Sales and revenue per JAL-9.
T&D Revenue Requirement per OSBA-2-24 (JAL-1C, p 5-6), incl GRT.

TABLE 2
PAGE 1 OF 2

Exhibit LS-10 Revised
(Revised LS-6)

Duquesne Light Company
Unbundled Rate Design
Residential - Rate RS

		Billing Units	Revenue	Rate
1	**Customer Charges:**			
2	Customer Bills	5,955,305	$38,233,058	$6.42
3				
4	**Distribution Charges**			
5	All kWh	2,977,045,069	$81,921,607	$0.02752
6				
7	**Transmission Charges**			
8	All kWh	2,977,045,069	$9,193,572	$0.00309
9				
10	**Generation Charges (Optional)**			
11	All kWh	2,977,045,069	$76,807,763	$0.02580
12				
13	**CTC Charges**			
14	All kWh	2,977,045,069	$94,997,508	$0.03191
15				
16	**Total Proposed Energy Charges**			
17	All kWh	2,977,045,069	$262,920,450	$0.08832
18				
19	**Total Current Energy Charges**			
20	All kWh	2,977,045,069	$349,505,091	$0.11740
21				
22				
23	**Total Proposed Charges**		$301,153,508	
24	**Total Current Charge**		$387,738,149	
25	**Rate Change**		-22.33%	
26				
27				

OFFICE OF CONSUMER ADVOCATE
INDEX OF TESTIMONY AND EXHIBITS

Exhibit	*Description*
OCA Statement No. 1	**Direct Testimony of Matthew I. Kahal (Evaluation of Duquesne's proposed stranded cost plan)**
Schedule MIK-1	OCA Overall Stranded Cost Summary
Schedule MIK-2	Excess Pre-Tax Earnings During Transition Period
Schedule MIK-3	Retail Rate Comparisons for 1996
Schedule MIK-4	DRI vs. Duquesne Inflation Rate Forecasts
Schedule MIK-5	Derivation of the Discount Rate
Schedule MIK-6	Productivity Enhancement Savings
Schedule MIK-7	PECO and West Penn Power Life-Extension Costs for Coal Plants
Schedule MIK-8	Cheswick Life Extension Costs and Net Benefits
Schedule MIK-9	Generation Net Merger
OCA Statement No. 1S	**Surrebuttal Testimony of Matthew I. Kahal (Response to Rebuttal Testimony on stranded cost issues)**
Schedule MIK-1 UPDATE	OCA Overall Stranded Cost Summary
Schedule MIK-6 UPDATE	Productivity Enhancement Savings
Schedule MIK-10	Projected Pre-Tax Operating Losses During Transition
OCA Statement No. 2	**Direct Testimony of Douglas C. Smith (Market Price Analysis)**
Exhibit DCS-1	Resume of Douglas C. Smith
Exhibit DCS-2A	New Combined Cycle Non-Fuel Cost Assumptions
Exhibit DCS-2B	New Combustion Turbine Non-Fuel Cost Assumptions
Exhibit DCS-3	Spring 1997 DRI Fuel Price Escalation Rates
Exhibit DCS-4	APS-DQL Market Price Estimate
Exhibit DCS-5	DQL Weighted Generation Price

OCA Statement No. 2S	**Surrebuttal Testimony of Douglas C. Smith (Response to rebuttal testimony on market price issues)**
OCA Statement No. 3	**Direct Testimony of Thomas S. Catlin (Regulatory asset issues, nuclear and fossil decommissioning, taxes and other transition costs)**
Schedule TSC-1	Summary of Regulatory Assets and Other Transition Expenses
Schedule TSC-2	Summary of Decommissioning Funding Requirements as of 12/31/98
OCA Statement No. 3S	**Surrebuttal Testimony of Thomas S. Catlin (Response to rebuttal testimony on preaccrued nuclear outage costs and unamortized debt costs)**
OCA Statement No. 4	**Direct Testimony of Lee Smith (Rate design, unbundling, cost allocation, and CTC design)**
Exhibit LS-1	Summary of Qualifications and Experience
Exhibit LS-2	Calculation of Market Price
Exhibit LS-3	1996 Administrative & General Expenses
Exhibit LS-4	Retail Cost of Service CTC Proposal
Exhibit LS-5	Retail CTC/Calculation of Levelized CTC
Exhibit LS-6	Unbundled Rate Design Residential - Rate RS
OCA Statement No. 4S	**Surrebuttal Testimony of Lee Smith (Response to testimony on treatment of ancillary service costs, line losses, A&G adder, and rates of return)**
Exhibit LS-7	Revised LS-4 (Retail Cost of Service)
Exhibit LS-8	Revised LS-2 (Calculation of Market Price)
Exhibit LS-9	Revised LS-5 (Retail CTC)
Exhibit LS-10	Revised LS-6 (Unbundled Rate Design)
OCA Statement No. 5	**Direct Testimony of Barbara Alexander (Consumer education and consumer protection issues)**
Exhibit BA-1	Resume of Barbara Alexander
Exhibit BA-2	Vermont Consumer Information and Education Plan
Exhibit BA-3	California Statewide Consumer Education Plan
Exhibit BA-4	Massachusetts Department of Public Utilities Code of Conduct

OCA Statement No. 5R	**Rebuttal Testimony of Barbara Alexander (Response to testimony on provision of generation services to default customers and supplier-only bill option)**
OCA Statement No. 5S	**Surrebuttal Testimony of Barbara Alexander**
Exhibit BA-S-1	Executive Summary of New Hampshire Pilot Program Survey Report
Exhibit BA-S-2	CAPUC Fact Sheets on Consumer Education Plan
Exhibit BA-S-3	Recommendations of the Maine Consumer Education Advisory Board
OCA Statement No. 6	**Direct Testimony of Nancy Brockway (Universal Service Issues)**
Exhibit NB-Duq-1	Resume and Curriculum Vitae of Nancy Brockway
Exhibit NB-Duq-2	Duquesne Estimation of Potential CAP Eligible Customers
Exhibit NB-Duq-3	Universal Service Costs - Per kWh Allocator
Exhibit NB-Duq-4	Development of Non-Production Revenue Allocator
OCA Statement No. 6S	**Surrebuttal Testimony of Nancy Brockway (Universal Service Issues)**

Exhibits Introduced During Hearings

OCA Cross Examination Exhibits Nos. 1-9

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the foregoing document, Office of Consumer Advocate's Main Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 10th day of February, 1998.

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February 10, 1998

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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:

Please find enclosed an original and 9 copies of the Main Brief of the Pennsylvania Retailers Association for filing in the above captioned proceeding. As indicated by the attached Certificate of Service, the presiding Administrative Law Judge and all parties of record have been served a copy hereof. A copy of the brief on a diskette has been provided to the Administrative Law Judge.

Should you have any questions or comments, please feel free to contact my office.

Sincerely,

STEVENS & LEE

Kenneth Zielonis

Kenneth Zielonis

/dle
Attachment

cc: B. Rider

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

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

MAIN BRIEF
OF THE
PENNSYLVANIA RETAILERS ASSOCIATION

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Dated: February 10, 1998

TABLE OF CONTENTS

I. Introduction and Summary of Argument.

A. Statement of the Case.

On August 1, 1997, Duquesne Light Company, ("Duquesne"), filed its restructuring plan pursuant to Section 2806 of the Pennsylvania Public Utility Code ("Code"). On August 6, 1997 the Pennsylvania Public Utility Commission, ("Commission"), assigned the restructuring filing to the Office of Administrative Law Judge. The Presiding Administrative Law Judge ("ALJ") is John H. Corbett, Jr.

On August 15, 1997, David Hughes filed a letter Petition to Intervene. On August 20, 1997, the International Brotherhood of Electrical Works, Local Council U-10 filed a Petition to Intervene. On August 25, 1997, the Commission's Office of Trial Staff filed a notice of appearance. On August 27, 1997, ARMCO, Inc. filed a Petition to Intervene in this proceeding. On August 28, 1997 the Pennsylvania Retailers Association, ("PRA"), filed a Petition to Intervene. On August 29, 1997, Enron Power Marketing filed a Petition to Intervene. On September 2, 1997 Allegheny Teledyne filed a Petition to Intervene. On September 4, 1997 Mid-Atlantic Power & Supply Association and Hospital Shared Services/ Administration Resources, Inc. filed Petitions to Intervene. A initial prehearing conference was held on September 4, 1997. At the prehearing conference a litigation procedural schedule was

established. A second prehearing conference was scheduled for October 21, 1997. This prehearing conference was subsequently cancelled at the request of the parties.

The Presiding ALJ has issued several interim orders. Such interim orders resolved discovery and procedural disputes as well as established the process for hearings in this proceeding.

Hearings to cross-examine Company witnesses were held the week of December 15, 1997 in Pittsburgh, Pennsylvania. Subsequently, the parties agreed that there would be no necessity for cross-examination of intervenor witnesses scheduled for the week of January 5, 1998.

As a result of several stipulations entered into by the parties, the testimony of intervenor witnesses was submitted without the necessity of cross-examination of such witnesses. In addition, several additional exhibits have been entered into the record in addition to those cross-examination exhibits entered into the record at the hearings held the week of December 14, 1997. The presiding ALJ closed the evidentiary record on January 20, 1997.

The record consists of numerous exhibits and statements of the individual party's witnesses. In addition, the record consists of a hearing transcript in excess of 1,000 pages.

The presiding ALJ has directed that Main Briefs be filed on or before February 10, 1998. The Pennsylvania Retailers Association submits this Main Brief in accordance with that directive.

B. Summary of Argument.

The Commission should reject Duquesne's approach of using results of a pilot program to determine the phase-in to retail generation competition. In addition, it is inappropriate to allow only one-third of individuals in each customer class to participate in the phase-in to retail electric competition in the generation market in Pennsylvania. Rather than accept Duquesne's approach, PRA suggests that the Commission adopt the approach contained in its testimony presented in this proceeding. That approach in essence permits customers to nominate up to two-thirds of their load beginning on January 1, 1999 with the expectation that certain customers may not participate in retail competition. By only permitting a nomination of one-third of each customer class' load as of January 1, 1999, the Commission will not be permitting the full customer class load of one-third to participate in the program.

The approach advocated by PRA is more consistent with the Legislative intent contained in the Electricity Generation Customer Choice and Competition Act, ("Act"). The Legislative intent is to have the greatest level of benefits resulting from a competitive generation market available to the greatest number of customers as quickly as possible consistent with appropriate cost recovery by all parties. In other words, PRA's proposal will allow for achievement of the Legislative intent of rapidly moving the retail

generation market to competitive market levels consistent with cost recovery by all market participants.

The Commission must also reject Duquesne's attempt to delay the establishment of recoverable stranded costs. Duquesne's approach of delaying the deadline for establishing stranded investment is inconsistent with the Act. The Act requires establishment of the CTC in this restructuring proceeding and does not permit delay. Moreover, establishment of the CTC at a later date is inconsistent with a competitive market. In a competitive market, prices are set presently and not at a future date as advocated by Duquesne. Duquesne's misgivings regarding long-term forecasts are misplaced and inconsistent with the Act. It is clear, for better or for worse, that the Legislature has established the mandatory statutory requirements. The policy of this Commonwealth is now reflected in the Act. The Act requires establishment of the CTC now and not in the future.

This requirement of establishing the CTC in this proceeding reflects a legislatively efficient balancing of the competing interests in this restructuring proceeding. The Legislature recognized that the CTC should be set by the Commission in this proceeding. In return for establishment of the CTC at this date, the Legislature allowed for 100% recovery of a just and reasonable level of stranded costs. Thus, the quid pro quo for recovery of an amount established in this proceeding was full cost recovery from ratepayers.

The Commission should also adopt an appropriate market rate that it is consistent with the evidence and that will insure an orderly transition to a competitive retail generation market in this Commonwealth. The level of stranded cost should be established in a manner consistent with the testimony of the Intervenors discussed herein.

II. Phase-In of Customer Choice.

A. Method of Customer Selection.

An important issue in this proceeding is the method of selecting customers who will be able to participate in a competitive retail generation market. An important factor for this Commission to consider is the guidance presented by it in its order involving the PECO Energy Company, ("PECO"), restructuring Order. Application of PECO Energy Company for Approval of its Restructuring Plan under Section 2806 of the Public Utility Code and Joint Petition for Settlement, Docket No. R-973953 (Order entered December 23, 1997). PRA's general interpretation of that Order is that the status quo of a regulated generation market no longer exists in Pennsylvania. The Legislature has expressed its policy intent, as contained in the Act, as foreclosing the maintenance of the status quo. It is PRA's interpretation that the Commission has adopted that Legislative intent in the PECO order. The Commission has interpreted the Act as requiring a truly competitive generation market.

In light of the above, it is PRA's recommendation that a method of customer selection be utilized which permits the rapid acceleration of that competitive retail generation market. This would entail adoption of the Commission's analysis of the issue in the PECO proceeding.

In this proceeding, Duquesne has suggested that the method of customer selection should be that contained in its testimony. Duquesne's witness Frank A. Hoffman indicates that large commercial and all industrial customers will be selected by SIC code-based market segments. Duquesne St. No. 6 at 4. In particular, Mr. Hoffman testifies:

> Duquesne's customers include 11 commercial and 5 industrial market segments. Some of these segments may be grouped to avoid competitive disadvantages. Duquesne proposes to prioritize the release of these market segments based on the results of our pilot program enrollment process. Those market segments having the largest percentage of total accounts being nominated by customers for participation in the pilot will be included in the first phase until the requisite class contribution is reached or exceeded. Id. at 4.

Duquesne also considered other proposals for phasing in access for large commercial customers. However, Duquesne's witness Hoffman indicated that he rejected these two other approaches. The first was a first-come, first-serve approach. PRA St. No. at 4. The second approach was one which would allow customer access for one-third of the load in the first phase, two-thirds of the load in the second phase and all of the load in the third and final phase. Id. at 4. Duquesne provided only one reason for rejecting this approach. Duquesne indicated that it rejected this approach:

> As presenting excessive difficulties in account administration and billing, triggering extraordinary volumes of customer contact and imposing unnecessary complexity and inconvenience on those customers.

Duquesne St. No. 6 at 5.

The Commission should reject Duquesne's proposal to implement phase-in using SIC codes. There are several problems with this proposal. First, the proposal lacks specificity as to the SIC codes that will be utilized. PRA St. No. 1 at 4. Thus, it is unclear as to how broadly or narrowly Duquesne defines the codes. Id. In addition, it may be that some of those market segment may compete with each other. Id. Indeed, when testifying upon cross-examination, Duquesne's witness Hoffman indicated that its selection of the SIC market codes was based upon initial customer contacts, some of which may have occurred many years ago. Tr. 1037. As a result, Duquesne witness Hoffman agreed there may be certain customers in different SIC codes which may compete with each other. Tr. 1039-1041. Duquesne incorrectly assumes that the market segments as represented by the SIC Codes do not compete across codes but only within codes. Consequently, there will be competitive disadvantages administratively created in the use of Duquesne's SIC code based selection process. PRA does not believe Duquesne should have the liberty to group competing marketing segments, especially where it likely will have limited market knowledge.

Duquesne also proposes to determine phase-in through the results of Duquesne's pilot program initiated in 1997. Duquesne proposes that the largest percentage of total accounts nominated by customers for participation in the pilot program, by segment, will

be included in the first year of the phase-in period. Duquesne St. No. 6 at 4. It is unclear whether this means the entire load or any part of the customer's load. PRA St. No. 1 at 5. In either case, however, it is inappropriate to tie access to the system for the transition to a competitive retail generation market to customer actions during the pilot program initiation period for the following reasons. Id.

There probably were a variety of reasons why individual market segments failed to participate or nominate their loads in the pilot program. Id. Not the least of these reasons is the short time period between initiation of pilots by the Commission and the beginning of the enrollment time period in the program. Id. Another apparent reason for failure of individual market segments to participate fully in the pilot program may be the general lack of alternate supplier information available to the public and the fact that only five percent of class loads would be available. Id. It is inappropriate to presume that the interest of parties in the pilot program replicates their interest and access to a market where all customers may procure competitive generation supplies. Id. at 5-6.

Thus, PRA presents a different position regarding retail access during the three-year transition period to a fully competitive generation market. The Commission should understand that large commercial customers operate in a highly competitive market and it is imperative that the phase-in procedure ultimately

adopted by the Commission not foster or create competitive disadvantages. Id. at 6. It is clear that Duquesne's proposal fosters and creates competitive disadvantages and, at the very least, does not attempt to eliminate competitive disadvantages among certain customers. Id. and Tr. 1038-1041.

Finally, under Duquesne's proposal, some customers may have participated in the pilot program but be unable to participate under a SIC-based formula. PRA St. No. at 9. While Duquesne intends to "grandfather" those customers participating in the pilot program, the process will undoubtedly create enormous customer confusion. Id. Further, the Duquesne process will guarantee the extension of the competitive advantage that pilot program participants have over their competitors that were not chosen, by lottery, for participation in either the pilot program or the initial phase-in to a competitive retail generation market. Id. Unlike the Duquesne proposal, the PRA proposal insures that customers who participate in the pilot program will be able to participate in a transition to a fully competitive retail market. Id.

PRA is also concerned regarding exceptions that Duquesne anticipates utilizing in its phase-in proposal. PRA is particularly concerned regarding the second exception. This exception provides that all customers taking service at a premise previously unserved by Duquesne will be allowed direct access upon commencement of the service. PRA St. No. at 9. This provides an

unfair competitive advantage to a new site by permitting it to benefit from retail generation competition. Id. While new job growth is a laudable goal, expansion of existing businesses should also be a complementary goal the Commission. Id. It is a short-sighted goal which defines economic development as applicable solely to new business locating in the Commonwealth. PRA St. 9-10.

Furthermore, it is unfair to place limits on existing businesses that have been subject to the high cost of electricity in Pennsylvania in order to provide benefits to new business locating in Pennsylvania. Id. at 10. In essence, the Duquesne proposal creates a competitive disadvantage for competitors of the new business that are not chosen to participate at the same time. Id. Under the PRA proposal, if a new business locates in Duquesne service territory, it increases the peak load amount, thus allowing the participation of the new business on an equal basis with existing customers. Id. Finally, any customer with multiple business sites in the Duquesne service territory should be permitted the opportunity to assign awarded participation levels in the manner of its choosing. Id. at 11. For example, if a customer has three locations of equal size and is allowed to phase-in one-third of each location in the first year, that customer should have the opportunity to place all its awarded load at one location. Id. at 11. Such a policy can benefit both the customer and Duquesne. Id. In addition, it may relieve Duquesne of certain administrative

costs of dealing with access by three locations. It is clear that such a position is consistent with the Act.

B. Timetable for Phase-In

In keeping with the above guidelines, large commercial customers should be permitted to participate in the deregulated generation market for a minimum of one-third of their customer load during each year of the three-year phase-in periods contemplated by the Act. Id. Such customers could nominate initially up to two-thirds of their load with the assurance of receiving access for at least one-third of their load. Id. If the nomination process for the first year produces an undersubscription of the total peak capacity subject to the Act, then those who initially nominated should be permitted to increase their nominated amount proportionately to the undersubscription level, up to a maximum of two-thirds of their individual peak load amount. Id. The intent of the maximum two-thirds participation level is to avoid the potential need for decreasing a customer's participation in the second year of the transition period.

In addition, since it is unlikely that all customers in each class will participate in the phase-in period, it is necessary to have a procedure to insure that the customer classes, as a whole, reach the statutory objective of one-third of each customer classes' peak load. Id. PRA believes that a failure to adopt such

a procedure will not achieve the statutory goal of the rapid development of a competitive generation market. This frustrates the intent of the Legislature to make the benefits of generation competition as widely available as possible during the transition period. Id. at 7. PRA witness Albrecht testified that Duquesne's concerns regarding excessive difficulties in account administration and billing and imposition of unnecessary complexities and inconvenience on customers is misperceived. Indeed, what is troublesome to PRA is that Duquesne is more concerned about perceived increased administration rather than maximizing the amount of customer benefits that can be achieved through a more robust phase-in that virtually assures the statutory goals of one-third of a utility's load being phased in during each year of the transition period. Citing excessive difficulties and complexities as an excuse for not achieving the full level of annual phase-in goals is in direct contradiction to the purpose of the Act. Id.

The Commission also should establish a phase-in time table for direct access in the same manner as the PECO proceeding. That is all commercial customers should be permitted to nominate one-third of their load as indicated above by the January 1, 1999 and two-thirds of their load by January 2, 1999 with full retail access by January 1, 2000. In this fashion Duquesne's customers will experience a rapid transition to the competitive generation market.

This market will require numerous buyers and sellers to develop in a robust fashion. The larger the number of customers the Commission permits to participate, the more efficiently and quickly this competitive market will develop. Furthermore, any phase-in timetable that is inconsistent with the above discussion will automatically create competitive disadvantages for those customers that the Commission does not permit to participate. In that regard, this Commission will be required to devote precious administrative resources and time to these issues leaving little time to regulate the remaining utilities in the Commonwealth. Any phase-in procedure other than that proposed above is a severe administrative intrusion into the workings of a freely competitive market. It disallows those unfortunate customers who are not selected for participation in the market. It is a severe intrusion into the workings of a competitive market of numerous buyers and sellers who decide on their own to access a competitive generation market. For all these reasons the Commission should adopt proposal regarding retail access.

PRA's proposal is more consistent with the requirements of the Act. Unlike the Duquesne proposal, it eliminates the existence of competitive disadvantaging to any particular customer in a customer class. Id. at 8. It insures that, at a minimum, all customers possess the opportunity to nominate at least one-third of their load each year, thus insuring that all customers can participate in the benefits that the Legislature desires to flow

from the Act. This means that the benefits of generation competition will flow to the greatest number of customers willing to participate in the process. Id. The PRA method also achieves the statutory goals of insuring that all classes of customers benefit from generation competition (66 Pa. C.S. § 2802(7)) and resolves a transitional issue (access to a competitive retail generation market) in a manner to fair to all involved (66 Pa. C.S. § 2802(a)). In sum, the PRA proposal does not competitively disadvantage one customer over another as the Duquesne proposal virtually anticipates.

III. Transmission and Distribution Rates; Unbundling Issues

A. Introduction.

1. The Act.

Section 2804(3) of the Act requires a local distribution electric utility to "unbundle" or disaggregate it current services, tariffs, and customer bills. 66 Pa. C.S. § 2804(3). This unbundling of existing rates is necessary to provide separate charges for the generation, transmission and distribution services that will be offered prospectively by such entities. Id. The Commission stated in PECO that a paramount issue in reviewing proposed unbundled charges is a statutory requirement that unbundled rates must be capped at the level approved as of January 1, 1997. PECO, supra, at 49. This rate cap remains in place for a specific statutory time period. 66 Pa. C.S. § 2804(4).

Finally, the Act sets forth another specific provision regarding transmission and distribution services and rates. The Act requires that the Commission must ensure continued safe and reliable electric service to all customers. 66 Pa. C.S. §2804(1)(ii).

2. The PECO Decision.

In the PECO case, this Commission had the first opportunity to interpret the various provisions of the Act concerning the above statutory provisions. Therein, the Commission stated that while it was required to unbundle charges, equally important in its analysis was the statutory mandate that those individually, separate prospective charges not exceed the component rate levels for generation, transmission and distribution which exist in bundled rates as of January 1, 1997. PECO at 52. The Commission also interpreted the Act to require that "rate caps as well as cost shifting concerns must be reviewed in the context of rate classes and/or rate schedules, not system-wide averages." PECO at 53. Finally, the Commission interpreted just and reasonable unbundled transmission and distribution rates as those which would not jeopardize existing service quality. PECO at 58. In other words, prospective transmission and distribution rates and charges should produce sufficient revenue levels to permit necessary replacement and/or improvement to existing infrastructure.

3. The Duquesne Method.

Under its proposal, Duquesne is rolls into existing rates an Energy Cost Rate, ("ECR"), equal to the ECR cap approved by the

Commission as part of the Ft. Martin Plan. Duquesne St. No. 5 at 8. In other words, Duquesne seeks to increase its December 31, 1996 rates in an amount equivalent to the ECR roll-in amount. Additionally, rates have been unbundled using a "residual" method calculation. Id. at 9. By this, Duquesne subtracts established rates for transmission, distribution and ancillary services, from existing rates. Id. The remainder, or residual, will be the maximum generation cost that can be recovered from customers. Id. Duquesne then divides the residual into two components, a market-based generation component, ("CGC"), and an above-market component or CTC. Id.

In regard to the allocations related to each functional category, Duquesne has maintained, to a certain extent, consistency with the allocation methodologies used for the bundled components of generation, transmission and distribution costs to develop unbundled generation and distribution rates. Id. at 15. Transmission costs are allocated to each rate class using the 12 coincident peak, ("CP"), methodology. Id. Distribution costs are allocated first on the basis of the voltage level at which customers take service. Id. at 17. Next distribution costs are divided into customer-related and demand-related costs. Id. at 17. Generation costs were allocated using the average and excess methodology. Id. at 18. Such costs were classified as energy-related and demand-related. Id. at 18.

B. 1996 Test Year Costs of Service.

It is difficult to accept Duquesne's 1996 cost of services levels in that the last Commission approval of base rates occurred in 1986. This militates against acceptance of many of Duquesne's recommendations in this proceeding.

C. Required v. Realized Rates of Return.

In this proceeding, Duquesne has developed unbundled rates utilizing its claimed or requested rate of return or cost of capital. DII St. No. 1 at 37; OCA St. No. 2A at 5. Duquesne utilizes this claimed 9.61% rate of return for each rate class rather than the rate of return actually earned by each rate class under existing rates. OCA witness Smith described the problem with this approach:

> In order not to overcollect, the Company adjusted the generation portion of the rate. In other words, if a class had actually earned a rate of return of 8% on rate base, the Company developed a rate for that class which included a 9.61% rate of return on distribution rate base, then reduced the generation component of that rate class in order not to increase the total rate. This effectively meant that class would pay even less than its average return of 8% on rate base.

OCA St. No. 2A at 5.

It is inappropriate to use this methodology in this proceeding for other reasons. DII witness Baron highlights the inappropriateness of Duquesne's methodology:

> Although such an approach might be appropriate in a rate proceeding in which class rates are going to be adjusted toward cost of service, it is not appropriate to use these results in this proceeding, since the current bundled rates reflect the earned rate of return produced by the rate class, and not [Duquesne's] desired rate of return. As such, I have utilized the earned rate of return for each rate class to compute the distribution revenue requirements for each rate class in my unbundling analysis. This is consistent with the approach that other electric utilities in Pennsylvania have used. In general, I support the concept that rates should be based on cost and that each customer class (and therefore class function within the class) should pay a rate of return based on this system average rate of return. However, since this is not a rate case and rates cannot actually be adjusted, the Company's proposal is not appropriate. In fact, it effectively results in a cost shifting in violation of the Competition Act since the generation component of the unbundled rates for each rate schedule is computed as a residual [under the Duquesne methodology]. 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. This occurs because [Duquesne] has set the distribution rate at an equal rate of return level, despite the fact that the rate class may not be earning that rate of return.

Id. at 42'

There is a further and more egregious reason why the Commission may not utilize Duquesne's claimed overall cost of

capital. The use of such claimed cost of capital, as noted by OSBA witness Kalsic, would violate the nongeneration rate cap requirement contained in the Act. In a very real sense, Duquesne's proposal to calculate unbundled distribution rates prospectively on the basis of its claimed cost of capital is equivalent of a request to increase current distribution rates. OSBA St. No. 1 at 7. This is obviously prohibited by the Act until mid-2001. In other words, under the Company's proposed unbundled distribution rates, any customer who purchases generation from an alternate supplier would be charged an unbundled distribution rate that exceeds the charge previously approved by the Commission, i.e., the charge contained in currently bundled rates. Id. at 7.

For all the above reasons, the Commission must reject Duquesne's request to include a proposed claimed cost of capital in calculating distribution rates rather than the actual earned rates of return for each class.

D. Distribution Losses.

In its filing, Duquesne proposes to shift line loss revenues and costs from the production function to the distribution function. Duquesne has included, at embedded costs, the cost associated with line loss in its proposed distribution

rates. DII St. No. 1 at 39. DII Witness Baron emphasizes the inappropriateness of this cost shifting:

> This represents a shift of revenue requirements from production to distribution for a service that a customer may or may not wish to utilize, even if the customer is a delivery service customer using an alternative generation supplier. Such delivery service customers can purchase loss compensation capacity and energy from an alternative supplier and should not, under any circumstance, be required to purchase the capacity and energy of loss compensation from [Duquesne] as an embedded component of the distribution rate. Since [Duquesne's] customers are captive to [Duquesne] for distribution service, this is simply an application of monopoly power by the Company and should be rejected by the Commission as an adjustment to the Company's unbundled cost.

DII St. No. 1 at 39.

The flaw in Duquesne's analysis is most telling when applied to full-service customers. DII Witness Baron highlighted this error:

> In addition, the Company's adjustment is even more egregious with respect to full-service customers who continue to buy generation resources from [Duquesne]. The costs associated with loss compensation are appropriately included in the generation component of [Duquesne's] unbundled rate. The recognition of losses in the calculation of generation and CTC costs (associated with generation) properly compensates [Duquesne] for providing loss compensation capacity and energy to its full-service customers. It is completely unreasonable and inappropriate to include these costs in the distribution charges themselves. Furthermore, the Company has included the costs of loss compensation capacity and energy at full embedded cost, without recognizing that, once the Company's

> stranded cost liability has been satisfied, the capacity and energy associated with loss compensation will be priced at market clearing levels, rather than embedded cost levels. Again, since loss compensation is a generation cost and not a distribution cost, it is inappropriate to add these to the distribution rates that all [Duquesne's] customers (both delivery and full service) are required to pay. With respect to distribution, [Duquesne] will continue to be a monopoly provider and it is therefore proper to remove this cost from the Company's rates.

DII St. No. at 39-40.

OCA witness Smith also highlights a further flaw in Duquesne's analysis. Such flaw relates to the scenario of a fully unbundled functioning and competitive retail generation market:

> Rate unbundling should produce results that are consistent with full unbundling of functions. If a separate transmission company or transmission affiliate were formed, it would not own any generation, but would have to purchase generation services from another entity in order to provide for line losses in ancillary services. This arrangement would require regulatory oversight to ensure that the transmission utility does not use its monopoly in the provision of line losses to sell line loss energy at more than costs.

OCA St. No. 2A at 4

The Commission must reject Duquesne's proposal to includes line losses in the distribution rate. Line losses relate solely to the production function and should not be transferred to Duquesne in a competitive generation market.

E. Ancillary Services.

There are several ancillary services that will be provided prospectively either by Duquesne or alternative generation suppliers. They include the following ancillary services:

1. Scheduling, system control and dispatch.
2. Reactive supply and voltage control from generation sources.
3. Regulation and frequency response.
4. Energy imbalance.
5. Operating spinning reserves.
6. Operating supplemental reserves.

In calculating its unbundled rates, Duquesne has inappropriately included certain ancillary services costs in unbundled transmission rates. DII witness Baron appropriately removed production-related ancillary services from unbundled transmission rates. DII St. No. 1 at 37. Such costs are more appropriately included in the market price component of the unbundled generation, purchasable from suppliers of such service. Id. OCA witness Smith appropriately recognized this fact:

> Competitive suppliers could provide most ancillary services. The Company's own testimony states that energy imbalance service and regulation and frequency control can be provided by other suppliers through dynamic schedulings; essentially by running an alternative control area. Currently ECAR requires that spinning reserves be provided

> from within the control area. That rule is subject to change, and spinning reserves could be provided within the control area by either purchasing exiting generation or by building new generation within the area. Thus, it appears that only scheduling and reactive power services are unlikely to be provided through the competitive market. This is consistent with FERC Order 888.

OCA St. No. 2A at 2

F. Voltage-Differentiated Rates.

PRA has no discussion of this issue.

G. Other Issues.

PRA has no discussion of this issue.

H. Conclusion

The Commission should adopt the above changes to unbundled distribution rates. A failure to do so will result in inappropriate cost allocations.

IV. Transition or Stranded Costs.

A. Overview of Stranded Cost Valuation and Recovery Approaches.

1. Introduction.

(a) The Act.

The Competition Act mandates that the Commission establish a level of transition or stranded cost that it determines is just and reasonable. 66 Pa. C.S. § 2804(13). Section 2804(14) of the Act requires the Commission to establish a transition to a competitive retail generation market that, inter alia, is fair to ratepayers and provides shareholders with a fair opportunity to fully recover the amount of transition or stranded costs that it determines is just and reasonable. 66 Pa. C.S. § 2804(14).

Transition or stranded costs are defined variously within the Act. The definition of transition or stranded cost is found in Section 2803 of the Act:

> "Transition or Stranded Costs." 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. This term includes:

(1) Regulatory assets and other deferred charges typically recoverable under regulatory practice, the unfunded portion of the utility's projected nuclear generating plant decommissioning costs and cost obligations under contracts with nonutility generating projects which have received a commission order, the recoverability of which shall be determined under Section 2808(c)(1) (relating to competitive transition charge).

(2) Prudently incurred costs related to cancellation, buyout, buydown or renegotiation of nonutility generating projects consistent with Section 527 (relating to cogeneration rules and regulations), the recoverability of which shall be determined pursuant Section 2808(c)(2).

(3) The following costs, the recoverability of which shall be determined pursuant to Section 2808(c)(2):

(i) Net plant investments and costs attributable to the utility's existing generation plants and facilities.

(ii) The utility's disposable spent nuclear fuel.

(iii) The utility's long-term purchase power commitments other than the costs defined in paragraphs (1) and (2).

(iv) Retirement costs attributable to utility's existing generating plants other than the costs defined in paragraph (1).

(v) Other transition costs of the utility, including costs of employee's severance, retraining, early retirement, outplacement and related expenses, at reasonable levels for employees who are affected by changes that occur as a result of the restructuring of the electric industry occasioned by this chapter.

The term includes any cost attributable to physical plants no longer used and useful because of the transition to retail competition. The term excludes any amounts previously disallowed by the Commission as imprudently incurred. To the extent that the recoverability amounts that are sought to be included as transition or stranded costs are subject to appellate review as of the time of the Commission determination, any determination to include such costs shall be reduced to the extent required by the results of that appellate review. 66 Pa. C.S. § 2803.

(b) The PECO Order.

In PECO the Commission interpreted the statutory definitions noted above and provided the interaction of these provisions of the Code. The Commission held:

> No transmission or distribution costs are recoverable as a transition or stranded costs because transmission and distribution will remain monopoly services under regulated rates. Consistent with traditional ratemaking standards, the costs must be 'known and measurable'. Only 'net' transition or stranded costs are recoverable any [positive] generation related stranded costs must be offset by 'negative' stranded costs from the increase in value of other generation related assets. Only 'unmitigated' stranded costs are recoverable. The recoverable stranded cost amount must be identified on a 'present value' basis as of the date that competition begins, January 1, 1999. Lastly, costs attributable to plants that are no longer used and useful as a result of the transition to competitive generation may be recoverable, but previously disallowed and prudent costs are not recoverable.

If a claim for stranded costs is found to be recoverable stranded costs within the meaning of Section 2803, it must be fully recovered if it is a Section 2808(c)(1) or (2) stranded cost. Section 2808(c)(1) includes regulatory assets and other deferred charges that are not presently included in rates but which the utility is already entitled to recover through rate adjustments.... Nonutility generation contracts previously approved by the Commission, as well as prudently incurred costs to cancel or buyout such contracts, are also included in Sections 2808(c)(1) and (2)... Section 2808(c)(1) also includes recovery of the unfunded portion of the utility's projected nuclear generating plant decommissioning costs.

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 of the Act, the Commission must authorize a 'just and reasonable' amount for recovery. In exercising its discretion, Section 2808(c)(4) directs the Commission to consider the extent to which the utility's efforts to mitigate stranded investment have been 'reasonable under all the circumstances, including consideration of whether mitigation has been commensurate with the magnitude' of the utility's stranded cost. The Act imposes a duty on the utility to mitigate stranded costs 'to the extent practicable'. Section 2808(c)(5) requires 'equal consideration' of the utility's efforts undertaken over time..... to reduce or moderate levels' prior to the adoption of the Act.

In summary, in order to recover each component of the requested amount, PECO has the burden of proof, 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 tradition regulation but will not be recoverable in a competitive market. Once identified as an appropriately recoverable stranded cost, the Commission must determine a just and reasonable amount authorized for recovery.

2. Duquesne's Approach.

Duquesne's approach to the calculation of stranded costs is to forestall the ultimate determination until a future date. Specifically, Duquesne desires to analyze and determine stranded costs not as of January 1, 1999, the beginning of the phase-in period, but rather as of December 31, 2005. Thus, Duquesne provides what it considers to be a provisional estimate of its stranded costs as of the end of the transition period rather than at the beginning. OCA St. No. 1 at 6. The estimate is provisional in nature because Duquesne seeks the opportunity to revisit stranded cost valuation or market valuation in 2003 and obtain a final determination at that time. Id.

During the time in which the transition period runs, the CTC will be established annually based on the difference between the capped generation rate and the actual market price. Id. The actual market price itself would be determined by an auction of a block of wholesale power to be conducted annually by Duquesne on a prospective basis. Id. Duquesne intends to initiate final determination of stranded costs in the year 2003 through a three member arbitration panel. Id. If the arbitration panel finds that the market value of Duquesne's then existing generating units equals or exceeds net value, the CTC will be terminated prior to the end of the seven year period. Id. However, if the panel finds that stranded costs are likely to exist as of December 31, 2005,

Duquesne will continue to collect a CTC after that date to recover remaining stranded costs. Finally, under the Duquesne proposal, if the Commission rejects the finding of this panel and adopts a finding adverse to Duquesne, it reserves the right to divest its assets. Id.

This final valuation proposed by Duquesne is motivated by the Company's perception that there is too much uncertainty at the current time to reliably estimate stranded cost. This is because, in Duquesne's perception, a retail generation market has not developed and therefore it is inappropriate, and almost impossible to determine a market based cost of stranded assets as required by the Act. Therefore, Duquesne seeks to defer the matter to 2003 or 2004. There are several problems, however, with its deferral from a both practical standpoint as well as a legal standpoint.

While it may be true that performing market valuations on long lived plants is a difficult undertaking, the same would still be true in the year 2003. OCA St. No. 2 at 12. The requirement of performing a market valuation and convening a panel of experts will not dispel the uncertainty or controversy but only delay the undertaking of what will certainly be an uncertain and controversial project.

In addition, this deferral of the determination of the level of stranded costs recoverable from ratepayers is contrary to the dictates of the Act. The Act requires a rapid deployment of a competitive retail generation market in Pennsylvania. An important

component of the development of that market is the recovery of stranded investment by electric utilities. This is important to both the electric utility as well as the customers as it insures that (1) utilities have a fair opportunity to permit their investors to recover their investment in Pennsylvania plant and (2) insures that ratepayer have a complete understanding of the cost of entering the competitive generation market i.e. the cost of paying for stranded investment in their electric utility.

While it may be true that there is uncertainty with respect to future market prices, that is simply a function of the market itself. In order to implement effective retail generation competition in the Commonwealth, it is necessary to develop a fixed level of stranded cost recovery despite that uncertainty. As indicated by DII witness Baron, the type of analysis that must be performed in this proceeding is no different than the type of analyses that [Duquesne] has traditionally engaged in with respect to generation planning and economic decision making regarding the type of generating unit to add to its system. It has been a fact of life in the electric industry that long-term forecasts are required to make decisions. DII St. No. 1 at 26. Thus Duquesne and the Commission are performing a similar function to what has been conducted in the past. It is both contrary to past practices as well as to the Act to defer a finding of stranded costs until a future time. There are other practical considerations to Duquesne's proposal. For example, as OCA witness Kahal indicated,

there are some questions as to whether the auction method of establishing an annual market price is appropriate. This witness testified:

> My concern is that this will establish a depressed market price proxy, leading to overstated CTC charges at ratepayers' expense and to the benefit of Duquesne. As Duquesne participates in the emerging competitive market, it will be seeking to market its power supply customer groups at the highest possible prices in order to maximize its revenue string. A passive wholesale auction, with no price negotiation, is hardly consistent with the aggressive marketing and revenue maximization we would expect of Duquesne.

OCA St. No. 2 at 12

Nor is there any assurance that such auction prices developed through this annual price benchmark analysis will be available to Duquesne's existing retail customers. As the OCA has indicated there is no guarantee or reason to believe that Duquesne's customers will be able to purchase their power supply at these auction prices. Id.

The auction conducted by Duquesne which forms the basis for a portion of the Duquesne proposal was deficient in several respects. In particular, the RFP was designed to reflect the incremental cost of electricity solely in the Duquesne area. HSS St. No. 1 at 26. It was not designed to reflect a market price in the entire ECAR region, the likely supply area in a competitive retail generation market. Id. As a consequence of the narrow design of the RFP, it did not reflect the prices outside of Duquense's service territory nor did it adequately represent the impact of the

dynamics of future supply and demand in the region. Id. The terms and conditions of the RFP were prescriptive which diminished the value to potential buyers. Id. That is power was offered for a specific, established time period (one or eight years starting in 1998) with no flexibility for a different start date for power flows or different term lengths. Id. at 30. Thus potential buyers were limited to those bidders seeking baseload power. Further potential buyers were not provided assurances of firm transmission rights over the Duquesne system. Id. at 26. The tested market was for wholesale power and not retail power. Id. at 27. The solicitation was for energy only and did not reflect ancillary services nor transmission services to the customer's location. Id. at 26. Finally, the proposed contract had a take-or-pay provision at relatively high capacity factors. Id. This would have resulted in a high delivered price when combined with the lack of firm transmission rights. Id. All of these interrelated factors would tend to reduce bid prices and understate the cost of power in a future market. Consequently, the Duquesne RFP cannot be utilized in this proceeding as evidence of a future market price as it is a poor predictor of future power prices.

In addition, Duquesne's proposal to defer calculation of a definitive stranded cost level is primarily one which shifts risk associated with stranded costs from customers to stockholders ad DII witness Baron indicated:

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

DII St. No. 1 at 24.

It is also clear that the Legislature never intended customers to face exposure to uncertainty regarding the CTC. Rather, it is for this reason that the Legislature has required, through the Act, that the CTC be established during the restructuring period and not at a future date. Customers are entitled to some certainty as to the cost they will pay through the CTC in order to evaluate properly their necessity of accessing a competitive retail generation market.

This proposal of Duquesne also represents a continuation of the current regulatory environment through the year 2003. During that time period, Duquesne essentially collects revenues in the same manner in which it currently collects such revenues from its existing customers. However, if a Duquesne customer desires to purchase from an alternative supplier, there is no certainty as to the level of the CTC charges the customer will face in any given

year. The problem this creates has been emphasized by DII witness Baron:

> The yearly CTC charge would be determined through an automatic process based on Duquesne's yearly RFP process. This is an unacceptable approach for rate making and would severely diminish the process of retail competition for Duquesne's customers. The [Duquesne] methodology would inhibit a customer's ability to enter into a supply contract for a duration of more than one year because that customer cannot know what its CTC responsibility will be for these future years (and the corresponding target market price necessary to realize savings).

DII. St. No. 1 at 25

This hindering of the development of a robust competitive market is contrary to the express desire of the Commission in the PECO proceeding. Therein, the Commission rejected the Joint Petition for Settlement because it would hinder the development of a competitive market. In a similar fashion, Duquesne's establishment of a CTC on an annual basis and correspondingly establishment of a market based generation rate, CGC, on an annual basis will not allow for establishment of a robust competitive market. As indicated by DII witness Baron, customers will not be able to purchase on a long-term basis as the CTC will be unknown for any time period longer than one year. This creates an artificial infringement on the development of the retail generation market in Pennsylvania and should be rejected by the Commission.

Duquesne's proposal to defer action to calculate definitively stranded cost is contrary to the law in that it

proposes to have a three person panel determine such final valuation. This clearly violates the requirement that the Commission, through open evidentiary hearings, establish a stranded investment level for each electric utility in the Commonwealth. It is not clear that the Commission may defer its statutory obligation to a three person panel created by administrative fiat. As such, this provision also supports rejection of Duquesne's proposal.

3. Intervenors Approach.

The Intervenors in this proceeding, on a mostly consistent basis, contend that the Commission must establish the level of recoverable stranded investments in this proceeding as of January 1, 1999 rather than the delay proposed by Duquesne. As indicated by OCA witness Kahal, stranded costs:

> . . .refers to those costs which would be recoverable from utility customers under traditional regulation but which the utility will not be able to recover under a competitive industry structure. What gives rise to stranded cost is the expectation that once competition in generation is introduced, competitive forces and efficiencies will lead to market prices which will be lower than the utility's per unit full imbedded cost (computed using traditional regulatory principles). Of course it is also possible that market prices could exceed regulated rates in which case stranded costs would be negative.
>
> There are three concepts regarding stranded costs which must be kept in mind at the present time. First, stranded cost relates only to the power supply (i.e., generation plus purchase power) portion of an electric utility's business since the

> other functional areas will remain regulated, not subject to direct competition (at least for now). Second, policy makers and regulators normally recognize only those stranded costs net of reasonable mitigation efforts, i.e., net efficiencies and other feasible measures which could reduce imbedded costs and/or enhance asset value. Third, stranded costs must be evaluated on a 'net' basis, i.e., the above market and below market value assets should be permitted to offset.

OCA St. No. 1 at 4.

DII also contends that stranded costs should be established in this proceeding. DII witness Baron calculates the level of recoverable stranded costs on a residual basis in a manner similar to that proposed by Duquesne. DII St. No. 1 at 11. In addition, DII suggests that there be a sharing proposal regarding the recoverable level of stranded investment. Under its proposal, the return allowed on stranded investment would exclude the cost of common equity, i.e., the return should only be the weighted cost of debt and preferred stock. DII St. No. 1 at 13. If securitization is used, however, the transition bond cost factor should be the rate of return utilized for recovery of investment in stranded costs. Id.

4. Conclusion.

The Commission should reject Duquesne's proposal to forestall the calculation of the CTC in this proceeding and its proposal to rely upon an annual RFP as a method of computing

stranded costs. Adoption of either proposal will not lead to an appropriate determination of stranded costs.

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

1. Introduction.

In this proceeding, the vast bulk of stranded investment claimed by Duquesne consists of its ownership interest in generation plants utilized to serve its customers. As indicated by OCA witness Kahal:

> It is attributable almost entirely to [Duquesne's] three jointly-owned nuclear units, Beaver Valley 1, Beaver Valley 2, and Perry. Inclusive of the Beaver Valley 2 lease and incremental nuclear decommissioning funding needs, the book cost of these plants is in excess of $1 billion. Unfortunately, these plants are so costly to operate on an ongoing basis, that they can be expected to provide only modest net revenue over their remaining lives to offset the enormous net book values of the units. By comparison, with the exception of one plant, Duquesne's coal-fired units appear to be economic and have little or no stranded cost.

OCA St. No. 1 at 8.

It should always be remembered that Duquesne has the incentive to understate the market value of its assets. It should also be emphasized that this understatement of market value works to the double benefit of Duquesne. The first benefit relates to an accelerated recovery of its investment and plant beyond traditional

rate making principles. The second benefit, results from this accelerated recovery, in that it will make Duquesne's generating plants, assuming future ownership, extremely competitive in the open retail generation market that should reach maturity in the year 2005. That is, as Duquesne reduces its cost structure through recovery of stranded costs, it places itself in a super-competitive position vis-a-vis other suppliers of electricity in a retail generation market. HSS St. No. 1 at 13. Thus an overrecovery of stranded costs will impede the development of such a market in the Commonwealth as it will be difficult for alternative suppliers to enter the market. This in turn frustrates the Legislative intent of the Act and returns Pennsylvania to a market now controlled by an unregulated monopoly, the worst of all worlds.

2. Net Book Value.

(a) Total Net Book Value.

The total net book value that should be utilized for calculating Duquesne's stranded investment in owned-generating plant should be that specified by the OCA.

(b) Treatment of Beaver Valley 2 Lease Costs.

The Beaver Valley 2 lease costs should be treated in the manner recommended by OCA witness Kahal. That is, the net book value of Beaver Valley 2 should include the net present value, ("NPV"), cost of the Beaver Valley 2 lease agreement. OCA St. No. 1 at 21. It should be noted that Duquesne includes the lease as a regulatory asset. Id. The OCA correctly recognizes that Beaver Valley 2 is in reality owned by Duquesne with the sale leaseback method being nothing more than a financing vehicle for that plant. Id.

(c) Recovery of Phillip and Brunot Island Costs.

The cost of the cold storage units of Phillip and Brunot Island should be included in the net book value as recommended by the OCA. That is, the net book value of Duquesne's generating plant should include $64.06 million for plants in cold reserve. Id. at 22. In addition, the stranded cost analysis should include $45.62 million for working capital. Id.

3. Market Value.

(a) Introduction.

As expected, this issue was the most controversial subject in this proceeding. The conclusion reached as to the

market value of assets results in a significant swing in the level of stranded costs the parties deem just and reasonable. Obviously the higher the market value, the lower the stranded investment and vice versa. Again to state the obvious, Duquesne seeks the lowest market value possible in order to insure the largest recoverable amount of stranded investment and to insure the greatest competitive position once the retail generation market begins to mature in the next century.

(b) Market Price Projections.

The estimation of generating revenues assumes that there will exist a competitive spot market for wholesale electricity in which bidders offer service at market-based prices. OCA St. No. 2 at 3. A system operator will select a bid which minimizes its total system cost at which it will sell to retail customers. Id. A reasonable approach for calculation of a market price is to assume that the value of a generating unit's output will be the marginal cost of production for the region in which the generator operates. OCA St. No. 2 at 4.

OCA witness D. Smith explained how this market will develop on a prospective basis:

> The principal buyers of energy and capacity will be load serving entities, which today consist of electric utilities like Duquesne which sell electricity to retail customers. Under retail competition, load

> serving entities could also include new entrants that seek to sell electricity at retail, and either generate their own power or purchase it from others. Load serving entities will require sufficient electrical energy to serve their customers' peak electricity demand, along with a reserved margin of installed generating capacity to call upon in times of high demand and/or outages of major generating units. The electricity market represents an hourly interaction between supplies (the various generating units available within the market area, and purchases from outside the area) and demand. . .

OCA St. No. 2 at 4.

In order to calculate an appropriate market value, several intervenors selected different models which were designed, on varying bases, to simulate the future competitive electricity market. Unfortunately as primary support, Duquesne did not utilize a specific model but rather assumed that future market prices cannot be projected at this time. Rather it utilized a suspect wholesale power auction as the basis a market value determination. See Discussion, supra. Other parties, however, utilize various models. The Office of Consumer Advocate utilized the ENPRO dispatch simulation model. The OCA's specific methodology was as follows:

> To simulate the interaction between the supply of demand and electricity, I conducted a dispatch analysis of the APS/DQL system using the ENPRO dispatch simulation model. ENPRO is a detailed, chronological model well-suited to represent a large electric system. The model is used by utilities and others for a range of operational and planning analyses. ENPRO represents unplanned (or 'forced')

> outages of generating capacity randomly on a daily basis, and planned outages are scheduled to the extent possible during off-peak periods. ENPRO was used to represent the APS/DQL system as a single market area. Imports are represented explicitly as available sources to be dispatched when economic. I have represented the energy market in terms of bids for delivered energy from each generating unit, with each bidder assumed to bid a price sufficient to recover its average variable cost, based on the unit's historical as-operated heat rate. (Emphasis in original).

OCA St. No. 2 at 5. It is assumed that offers by owners of such generating units will try to recover the unit's variable cost of operation (fuel and variable O&M costs). In addition, it is assumed that an additional source of revenue will be that collected from customers for alternative generator-supplied ancillary services. Id. at 6. Finally, it also is assumed that there will be recovery of capacity products which will be traded and will also permit recovery of a generator's fixed costs. OCA St. No. 2 at 7.

(c) Fuel Prices.

It is assumed that fuel prices will affect Duquesne's generation market revenues and the corresponding calculation of stranded generation costs. Duquesne owns generating units which burn a range of fuel but primarily coal. OCA St. No. 2 at 7. As a result, Duquesne's future operating costs will follow and depend strongly upon the delivered cost of coal and to a lesser

extent, the cost of other fuels such as natural gas. Id. Thus, the market revenues that Duquesne will receive, in the future, for the output of its generating units will depend significantly on prices faced by those generating units operating on the margin. Id. The existing supply mix in the ECAR area is similar to Duquesne's, i.e., coal fired unit's define marginal costs during most hours. Id. These relationships indicate that at least in the immediate future, Duquesne's fuel costs and corresponding generation market revenues will be strongly affected more by the price of coal than the price of other fossil fuels, primarily natural gas. Id. at 8. Over time, as new generating capacity is necessary, natural gas-fired combustion cycle generating units will have an increasing affect on market prices while Duquesne's fuel costs will still be driven primarily by cold. Id. As a result of this need for additional capacity both in the Duquesne market area as well as surrounding market territories, market revenues received by Duquesne's existing generating units will increase, thus lowering stranded investment costs associated with those units.

(i) Forecasting Methodology.

OCA witness D. Smith concludes correctly that new generating capacity that will be available to meet demand, growth and replace existing units will be for base load cycling duty, or large scale combined cycle combustion turbine plants

burning natural gas. Id. at 8. For peaking duty to meet the needs of customers, large scale simple cycle combustion turbine units are assumed to be available. Id. In the OCA's market price analysis, witness D. Smith assumed certain kW capital costs for both the CC option and the CT option. These values were developed based on a review of industry data and estimates provided by other utilities. Id. It can be expected, however, that some new units in the future will incur higher capital costs than the OCA assumed due to several factors including the following:

> 1. Higher interest rates during construction;
>
> 2. Increased CC/CT equipment costs from current market conditions, which represent a historic low point;
>
> 3. Greater land costs;
>
> 4. Greater project development costs representing soft costs needed to develop a successful project;
>
> 5. Nonstandardized plant features, reflecting trade-offs between plant design and capital costs;
>
> 6. Selective catalytic reduction equipment for control of NOx emissions on CC units; and
>
> 7. General plant costs.

Id. at 10.

The OCA chose a somewhat optimistic capital cost to reflect the fact that new units may be constructed at preferable sites rather than from the ground up and that there is

a potential for additional improvement in the CT and CC technologies over the planning horizon. Thus, the capital costs assumed for new generating capacity is extremely conservative in light of the development of the future retail generation market.

(ii) Input Assumptions.

The OCA summarized its primary input assumptions in its market analysis as follows:

> 1. Generating units and their seasonable maximum capacities were identified from the 1996 NERC Electricity Supply and Demand Database, and the FERC Form 1. The APS/DQL control area was defined to include generating capacity owned by affiliates of APS and Duquesne;
>
> 2. Actual annual fuel costs for existing generating units were obtained on a station basis for calendar year 1996, from FERC Form 423. From 1997 forward, fuel prices were based on escalation rates from DRI's spring 1997 price forecast;
>
> 3. Base fuel prices at Hatfield Ferry, Bruce Mansfield, Elrama and Mitchell stations were adjusted downward from historic values to reflect the anticipated expiration of above-market coal supply contracts;
>
> 4. Fuel prices at Hatfield Ferry, Harrison and Pleasants were adjusted from the year 2003 forward to reflect the planned utilization of gas reburn to control NOx emissions;
>
> 5. Variable O&M costs of existing generating units were based on

assumptions presented by PECO in Docket R-00973877;

6. Emission adders for SO2 and NOx were added to the dispatch price of thermal units, using the real (1997) values estimated by West Penn in Docket No.- 00973981;

7. Heatrates: The energy bid of each thermal unit is represented based on its average as-operated heatrate for 1996, as obtained from FERC Form No. 1;

8. Generating unit availabilities were developed for major classes of generating units, based on NERC records of 1990-1994 actual generating unit availabilities with certain exceptions;

9. Non-utility generating capacity was projected in accordance with the NERC 1996 Electric Supply and Demand Database. Unit costs and energy production assumptions were developed from the FERC Form No. 1; and

10. Projected peak load and energy requirement growth rates were based on the 1996 NERC Electric Supply and Demand Database; the hourly load shape was based on an average of the 1995 and 1996 actual hourly load shapes.

OCA St. No. 2 at 15-16. These assumptions should be utilized by the Commission in calculating the market value of Duquesne's stranded generating costs.

(iii) Results.

The market pricing results from the OCA's analysis are as follows:

Year	APS-DQL Market Price Estimate $/MWh	Duquesne Weighted Generation Price $/MWH
	All-Hours	
1999	$18.83	$19.42
2000	19.36	19.91
2001	19.51	19.96
2002	21.60	22.54
2003	26.36	29.28
2004	27.33	30.25
2005	29.15	31.45
2006	30.51	32.70
2007	32.75	35.08
2008	34.90	37.31
2009	36.84	39.18
2010	38.68	41.00
2011	41.70	44.13
2012	45.11	47.64
2013	47.96	50.47
2014	51.27	53.67
2015	53.70	56.25

OCA Exhibit DCS-4 and DCS-5.

4. Other Factors Affecting Market Value/Stranded Costs.

(a) Life Extensions.

Extension of the operating lives of generating plants beyond their "book or financial life" is common in the electric industry. OCA St. No. 1 at 35. The fact that Duquesne has failed to consider this factor in its stranded investment analysis is not a basis for its rejection. The Act requires that the Commission consider all possible mitigation strategies in

determining stranded investment. Life extensions of existing plants is a form of mitigation of the level stranded investment. Even under the Duquesne scenario of "testing" as of 2005 requires a review of the possibility of extending the lives of generating plants that are under review.

A reasonable estimate of the cost of extending the life of a coal plant has been provided by the OCA. In particular, the OCA has calculated a "base case" cost of $200/kW and a $300/kW capital cost in light of environmental uncertainty and the possibility of other future costs. OCA St. No. 1 at 37. The OCA analysis reveals that all generating units analyzed can be economically life extended at $200/kW capital costs although ineffective for only two units at $300/kW. Id. at 38. Thus the range of NPV of life extension is $200 to $171 million as of January 1, 1999. The OCA conservatively selected the $171 million amount. This position should be adopted by the Commission.

When low cost plants operate over longer periods of time, their below market costs can offset greater amounts of above market costs, i.e. offset stranded investment. Duquesne has both competitive and noncompetitive plants. Longevity of plant operation reduces the level of stranded investment. Duquesne erroneously assumes that its plants will cease operation when the cost of investment has been fully recovered for ratemaking purposes. HSS St. No. 1 at 67. Duquesne must economic retirement. That is upon full depreciation, currently noncompetitive plants may competitive

prospectively once their former depreciation expense is used to offset other operating costs. Id. at 68.

(b) Plant Shutdowns.

Again the Commission is required to consider all mitigation strategies in its stranded investment analysis. The Commission must consider the economic feasibility of plant shutdowns, keeping in mind the statutory requirements of determining the negative impact upon the surrounding community. PRA, however, does not provide a specific recommendation on this issue.

(c) Productivity Gains.

Productivity is the central tenant of a competitive environment. It was a major rationale for injection of competition into the retail electric generation market. OCA witness Kahal aptly describes its importance:

> The issue of productivity and efficiency is central to the introduction of competition into electric generation. Certainly, one of the primary reasons of moving from a system of regulated monopoly, subject to cost-plus pricing, to competition is the belief that competition will motivate new efficiencies in cost control benefits not attainable under regulation. Moreover, such efficiencies are not merely a one-time or episodic effort at cost control (e.g., a utility downsizing initiative at a given point in time) but will be

> continual. Once deregulated, the owners of generation assets will be seeking ways of controlling costs and improving productivity on an ongoing basis.
>
> In the context of electric restructuring cases, in Pennsylvania and elsewhere, such efficiencies are referred to as a form of 'mitigation', i.e., offsets to reduce uneconomic costs. Pennsylvania electric utilities are expected to address such mitigation efforts in their respective filings.

OCA St. No. 1 at 29.

A productivity gain has not been reflected by Duquesne in its stranded cost analysis. Utility operating costs, however, should be reduced as competition is introduced in the retail generation market. Id. at 31. This should include fuel costs, non-fuel, O&M, Administrative and General expenses and even possibly capital additions needed to maintain units and life extensions. Id. There have been several attempts to quantify productivity gains as a result of competition in the electric market. See OCA St. No. 1 at 32-33. The OCA has assumed reasonably a productivity gain beginning in 2003 and extending for 10 years thereafter. Id. at 33. This adjustment, however, is applied only to Duquesne's non-fuel O&M and A&G expenses. Id. at 34. The 1999 NPV of the productivity adjustment should be adopted by the Commission.

(d) Costs Independent of Operations.

PRA has not discussed this issue in this Brief.

5. Conclusion.

The above adjustments to stranded costs are reasonable in a competitive retail generation market and should be adopted by the Commission.

C. Merger Savings.

Should the Commission approve the merger of APS and Duquesne, then the stranded investment analysis must quantify those savings. The OCA estimated merger savings of $152.28 million at January 1, 1999 NPV as follows:

> I estimated those savings using the information in Mr. O'Brien's Exhibit MKO-2 in the merger docket. . . . Mr. O'Brien's study provides the year-by-year net merger savings (i.e., net of costs to achieve) for Duquesne each year through 2007. For example, in 1999 the net merger savings for Duquesne (net of costs to achieve) are $29.884 million. Mr. O'Brien also provides some information on merger savings for Duquesne by major function. According to his study, Duquesne's generation-related net merger savings, (other than joint expense savings), are 48.34% of its net total merger savings during the first 10 years.
>
> Using this rule of thumb relationship, I calculate the year-by-year Duquesne merger savings relating to generation on Schedule MIK-9. After calculating Duquesne's generation savings, I add $2.5 million per year (escalated at two and seven-tenths percent) for joint dispatch savings. After 2007, the merger savings are assumed to increase by

> 2.7% per year. Since I have not applied the DRI inflation adjustment to these merger savings, the results on Schedule MIK-9 are conservatively low.

OCA St. No. 1 at 39.

Stranded investment should be quantified both with merger savings and without merger savings.

D. Decommissioning Costs.

1. Nuclear Decommissioning Costs.

Duquesne's request for nuclear decommissioning costs consist of two components tied to its two-part stranded cost recovery proposal. The first component consists of Beaver Valley 1 and 2 and Perry decommissioning accruals which under its proposal are continued at currently authorized levels and then summed for the seven years of the CTC recovery period. DII St. No. 3 at 31. 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 levels. Id.

The Company, unfortunately, has not properly computed its claim. First, its quantification as of December 31, 2005 is inappropriate and should be quantified at December 31, 1998. Id. Second, Duquesne's computations fail to incorporate trust fund earnings. Id.

The total nuclear decommissioning stranded costs for the above nuclear plants should be calculated as proposed by DII. DII has calculated the net present value of such costs as follows:

> To compute the total stranded decommissioning cost, I utilized [Duquesne's] decommissioning cost estimates for each unit in 1997 dollars, escalated those cost estimates to the year of retirement plus the number of years representing the mid-point between the retirement year and the end of the post-retirement disbursement period by 2.5% annually, incorporating returns on a trust fund balance of 7.5%, and assumed post-retirement earnings on the trust fund balance to the same year as I escalated the cost estimate. I then discounted the net future year deficiency for each unit to December 31, 1998 utilizing the Company's after-tax cost of capital. The 2.5% cost escalation and 7.5% trust fund assumptions were provided by the Company.

Id. at 32.

The Commission should permit a nuclear decommissioning cost recovery level of $42.959 million on a net present value basis for Duquesne's nuclear plants.

2. Fossil Decommissioning.

Duquesne has made a claim for both nuclear and fossil fuel decommissioning costs. It has projected the cost of decommissioning its fossil fuel plants and relies upon three studies performed by TLG Services. DII St. No. 3 at 26. Such studies are highly speculative in that they are "the result of assumptions premised upon assumptions." Id. Inherently unreliable

fundamental assumptions include a premise that fossil plants will actually be retired permanently at the end of their book life and that the costs to fully dismantle are now known and measurable. Id. at 27. Due to the speculative nature of such projections, the Commission historically has rejected such proposals. Id. at 28-29. Thus, the Commission should reject Duquesne's proposal to recover projected fossil fuel decommissioning costs as a portion of stranded investment.

E. Regulatory Assets and Liabilities.

1. Introduction.

Regulatory assets and other deferred charges are recoverable as stranded costs if they are "typically recoverable under current regulatory practices". 66 Pa. C.S. § 2808(c)(1). Duquesne has claimed several regulatory assets and liabilities as components of its stranded cost recovery claim. They will be addressed in the following manner by PRA.

2. Disputes Regarding Specific Claims.

(a) SFAS 109 Deferred Taxes.

Duquesne has reclassified the SFAS 109 related asset for Perry and Beaver Valley 1 from plant-in-service to a regulatory asset. DII St. No. 3 at 10. Thus Duquesne's stranded cost analysis double counts the value of the asset once in plant-in-service and once as a regulatory asset. Id. The amount of the SFAS 109 asset related to plant to should be included in the Duquesne qualification of generation related stranded costs only.

(b) Unamortized Debt Cost.

Duquesne requests $58.98 million in unamortized debt costs. DII St. No. 3 at 11. Unamortized debt costs represent premiums and discounts paid by the Company to refinance its debt. Duquesne St. No. 2-R at 22. Duquesne recovers these costs through interest expense as a reduction to the debt balance outstanding and as an amortization amount included in interest expense. Id. These reacquisition premiums and debt issuance, as well as the carrying cost of these items, are contained in Duquesne's cost of debt. DII witness Kollen explains the effect of including these costs in Duquesne's weighted cost of capital and discount rate:

> ... is to increase the generation stranded costs by reducing the net present value of the future contribution margins. Thus the amortized debt costs are fully recovered as a generation stranded cost. Additional recovery as a regulatory asset is clearly inappropriate.

DII St. No. 3 at 13.

(c) Unamortized Sales/Leaseback Premium.

Duquesne's position on this issue is similar to the argument contained in (b) above. Duquesne St. No. 2-R at 24. Thus Duquesne claims the present value of the post-2005 amounts must be recovered as a regulatory asset. Id. Duquesne currently recovers this amount as an operating expense. DII St. No. 3 at 13. The net present value of the Beaver Valley lease payments at December 31, 1998 included by the Company as a regulatory asset also appear to include the amortization of the Beaver Valley 2 lease refinancing premiums. Id. at 13. The effect of improper inclusion in both generation stranded cost quantification and as a regulatory asset is an excessive quantification of stranded costs. This amount should only be included in the quantification of generation stranded costs. Id. at 14.

(d) Deferred Rate Synchronization Costs.

Duquesne's claim for deferred rate synchronization costs or, "early window", costs are those incurred by it at Perry and Beaver Valley 2 between the time the plants went into utility service and the time rates which reflected those plants were placed into effect upon Commission approval. Duquesne St. No. 2R at 25. Duquesne has quantified this amount as $33.43 million. DII St. No.

3 at 23. Under its proposal, Duquesne would amortize the unamortized balance by the end of the year 2005. Duquesne St. No. 2-R at 25. This amount should be valued at the net present value amount as of December 31, 1998 over the remaining amortization period and not the nominal amount at December 31, 1998.

(e) Deferred Employee Costs.

Deferred employee costs represent timing differences between the accrual of, and cash payment of injuries and damages and compensated absences. Duquesne St. No. 2-R at 26. It is inappropriate to allow these items because (1) the deferrals will reverse in the future since the accrual is merely a timing difference and (2) these costs are reflected in the recovery of generation related stranded costs. DII St. No. 3 at 18. There is no basis to include such costs as a regulatory asset.

(f) Deferred Coal Costs.

This amount represents costs which historically have been above market costs which limited the amounts which could be included in Duquesne's annual ECR. Duquesne St. No. 2-R at 27. These costs should be rejected because it requires an allowance for recovery of costs that were deemed to be in the past excessive and nonrecoverable in currently effective rates. DII St. No. 3 at 19.

The Act has not changed this fact as it merely permits costs recoverable under "traditional ratemaking" authority. Further there is no evidence that Duquesne will have below market costs in the future, a necessary predicate for recovery of these above-market costs. Id. This claim should be rejected by the Commission.

(g) Deferred Caretaker Costs.

This claim refers to the cost of maintaining Duquesne's cold reserved generating units approved for deferral in Docket No. P-900485. Duquesne St. No. 2-R at 33. These costs should be rejected because recovery would have been permitted only if the plants had been returned to service; there was never a guarantee of cost recovery. DII St. No. 3 at 20. Further, there is no evidence that such units will return to service. Indeed, as Duquesne has stated, the "For Sale" sign has been out on the plants for several years with no purchasers in sight. Duquesne St. No. 2-R at 33. Thus this claim should be disallowed.

(h) Pre-Accrual of Nuclear Outages.

Duquesne proposes to recover a regulatory asset associated with the pre-accrual for nuclear outage costs. Duquesne St. No. 2-R at 29. Duquesne argues for this accounting methodology

because it believes that it more closely matches the expense of outages with production from the nuclear unit. Duquesne St. No. 2-R at 29. DII witness Kollen emphasizes why such treatment is inappropriate:

> First, any deferrals for pre-accruals for outage costs no longer will be allowed under Generally Accepted Accounting Principles after the transition period to competition and rates for electricity suppliers are set by the market. Deferrals in pre-accruals are solely a function of SFAS 71, which provides special regulatory accounting dispensation to utilities whose prices are established by a regulatory agency on the basis of costs. That situation will no longer exist once Duquesne's generation is subject to market pricing. Thus, this request by the Company is fundamentally in opposition to future reality and should be rejected.
>
> Secondly, [Duquesne's] request would be zero if it had been computed properly. A return on any pre-accruals for outage costs should be provided to ratepayers for the advancement of funds either as a reduction to rate base or as a reduction to cash working capital requirements. In addition, in the last year of the nuclear units' lives, this pre-accrual will reverse, thus providing ratepayers a return of the amounts advanced to [Duquesne]. Because the ratepayers are entitled to both a return on and of any pre-accrued nuclear outage costs, the net present value of the pre-accrual should be zero.

DII St. No. 3 at 16.

(i) Transition Costs.

PRA has no discussion on this issue.

(j) SFAS 106 Deferred Costs.

Duquesne claims that the transition amount it seeks to recover is a "GAAP" liability which exists today, not a regulatory liability. Duquesne St. No. 2-R at 31. Duquesne further argues that because the liability was created in the regulated generation time period, customers should pay for these costs. DII witness Kollen recommends denial of this claim on the following basis:

> Recovery of any level of SFAS 106 costs in excess of cash pay as you go represents a prepayment by the ratepayers of cash years before it will be paid out in the form of benefits to retirees. At some time in the future, cash payments will actually exceed SFAS 106 levels. However, the amounts precollected from ratepayers will continue to earn either [Duquesne's] overall return if not deposited in an external trust fund, or the fund's overall return if deposited in an external trust fund. In any event, these earnings will serve to reduce future years' SFAS 106 expense either directly or indirectly through enhanced returns to shareholders due to avoided external financing. Thus, any recognition of SFAS 106 and stranded costs must of necessity be a regulatory liability for the net present value of future carrying charges that are owed to ratepayers.

DII St. No. 3 at 22.

For this reason the claim should be rejected.

F. Recovery of Stranded Costs.

1. Introduction.

Once stranded costs are quantified, the Commission must determine the allowed level permitted for recovery from ratepayers. The Duquesne plan for recovery of stranded costs contains several components. First, Duquesne seeks to maintain its capped rates over the entire transition period ending 2005. Duquesne's proposes to charge capped rates up to its allowed rate cap only until its stranded costs are recovered. Duquesne St. No. 2-R at 9. During the transition period, Duquesne will reduce its stranded costs through accelerated depreciation and amortization of its generation plant and its regulatory assets. OCA St. No. 1 at 8-9. This acceleration may be more rapidly deployed using the so-called ROE spill-over mechanism proposed by Duquesne. Id. at 9.

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

(a) Mitigation.

The Act affirmatively requires Duquesne to mitigate its level of stranded costs. As discussed earlier, certain of the stranded cost component disallowances in this proceeding are based

upon a need to mitigate. These should be adopted by the Commission.

(b) Sharing of Stranded Costs.

As described by Duquesne, both the OCA and DII have proposed methods of "sharing" of stranded costs between shareholders and ratepayers. Duquesne contends that (1) the OCA caps would disallow any return (debt or equity) on Duquesne's stranded generating assets and (2) DII would disallow any equity return on those equity assets.

It cannot be emphasized sufficiently that it is the Commission's duty and obligation to establish a "just and reasonable" level of stranded costs. The Act does not specify nor mandate a particular level of recovery of stranded costs. Contrary to the implications of Duquesne's statements, the Act does not insure 100% recovery of stranded costs. Rather, the Act reflects a balancing of competing positions noting that the recovery of stranded investment is a form of "accelerated depreciation" of recovery of generating assets over a seven-year time period rather than the remaining book life of the asset. As emphasized by OCA witness Kahal, this is a significant benefit in regard to the remaining thirty years over which recovery of the costs of Perry and Beaver Valley 2 would occur under standard rate regulation by this Commission. OCA St. No. 1-A at 9. Unfortunately, Duquesne

fails to take into account the significant financial benefit to shareholders. Finally, the DII proposal is merely an offshoot of the OCA proposal, yet it too relies on the correct interpretation that the Act does not require 100% recovery of stranded costs. DII's analysis to equate stranded generation costs with facilities that are no longer used and useful (from an economic perspective) in a competitive market environment is a useful analogy:

> Although the legislation implementing retail competition in Pennsylvania envisions that utilities will experience such stranded generation costs, and that recovery of those costs (after mitigation) should be considered by the Commission, the clear implication of the legislation is that these costs are no longer used and useful in providing electric service. It is also clear that stranded costs (representing intangible costs) do not provide electric utility service in and of themselves. Rather, they represent a transition from a regulated to a competitive environment.
>
> Given the nature of stranded generation costs, and the relative comparability to generating costs that had previously been considered by the Commission as being not used and useful (for example, excess capacity), I believe it is appropriate to consider a discount factor based on prior Commission remedies associated with the treatment of generating costs that had been found to be not used and useful. One such remedy that has been used by the Pennsylvania Public Utility Commission and other state commissions is the disallowance of an equity return on the investment associated with facilities that are found to be not used and useful. I believe that an equity return disallowance is an appropriate mechanism to adjust stranded generation costs for recovery from ratepayers through a CTC.

DII St. No. 1 at 16.

Duquesne simply misplaces the intent of the Legislature. In a competitive market, nothing is guaranteed; this is the clear import of the Commission's decision in the PECO matter. Further significant financial benefits accrue to utilities under the Act. Duquesne's approach upsets this Legislative intent by ensuring that it faces no risk in a competitive retail generation market since it receives 100% recovery of its existing rate levels and costs. This approach should be rejected by the Commission.

3. Method of Stranded Cost Recovery.

(a) Immediate Rate Reductions.

The OCA is correct from a conceptual standpoint that immediate rate reductions are necessary in the Duquesne service territory. Commercial customers in Duquesne's service territory have far too long paid exorbitant rates for electric service. Indeed, as this proceeding strikingly reveals, many of Duquesne's plants are uneconomic and customers have for years subsidized those inefficient plants. The Legislature enacted the Act to achieve cost savings in customers electricity costs or at a minimum to provide an opportunity for immediate rate relief. To assume otherwise is folly. Thus from a conceptual standpoint, any

stranded cost recovery method selected by the Commission must reflect this fact.

V. The Competitive Charge.

A. Conceptual Disputes Regarding the Calculation of the CTC/CGC.

1. Differences in Overall Approach.

In this proceeding two vastly different methods of calculating the CTC/CGC have been presented. The first approach calculates the CTC as the residual resulting from the "fall out" of existing capped rates. This is the approach supported by Duquesne and DII. The second approach is that advocated by the OCA which is to calculate the CTC as a specific number, not as a residual of what remains after subtracting T&D and the market generation rate from existing capped rates. OCA St. No. 2A at 4.

2. Other Conceptual Disputes.

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

In its proposal, Duquesne desires to calculate actual market rates on an annual basis. Duquesne St. No. 1 at 6. This actual market price would be established by an auction of a block of power to be conducted annually be Duquesne. (It should be

noted that this methodology is also used to set the CTC, i.e. on an annual basis. OCA St. No. 1 at 9.)

The inherent problems and illegality of this annual true up method have been discussed previously. See pages 30 to 37, supra. Suffice it to say that the Legislature rejected such a proposal in enacting the Competition Legislation. The Act requires the establishment of the CTC (and by definition the CGC) in this proceeding. There is no provision for an annual true-up of the market price. The Legislature recognized the risk of this method by allowing for full recovery of a just and reasonable level of stranded investment with the ability to correct for variations and customer usage. This ability to correct provides a significant comfort level to utilities which see a decline in sales.

The Act must be read as a whole and not in independent pieces. It must be read in the context of the entire piece of legislation. Annual calculation of the CTC/CGC was a legislative trade off to allow 100% recovery of a just and reasonable level of stranded investment.

(b) Determination of Class Responsibility for Stranded Costs.

Stranded costs should be allocated in the manner required by the Commission in the PECO proceeding.

(c) Levelized CTC or other methods.

The CTC should be calculated in this proceeding. It should be adjusted solely on the basis of variations in sales as required by the Act. 66 Pa. C.S. § 2808(f). The Act clearly rejects the creation of a levelized CTC. Again it should be recalled that the Act contemplates a radical departure from existing ratemaking principles. The Legislature did intend for the parties to achieve certainty in pricing or rates. Rather, for better of for worse, the Legislature has mandated that "competitive forces" shall now set generation prices in this Commonwealth.

(d) Duquesne's Rate Design Proposal.

Duquesne proposes to radically modify its existing rate structure. It proposes to unbundle its charges so that a portion of the CTC is collected through a fixed charge component while the residual is collected in the energy rate. There are several problems with this methodology.

As the OCA explains, Duquesne has not conclusively shown that its proposal results in a more efficient charge since it has not presented a marginal cost study demonstrating that such charges are equal to full marginal cost. OCA St. No. 4 at 8. Further, as noted by DII, the implication of this unjustified, radical change is that (1) the fixed cost component is paid regardless of consumption and thus equates to a take-or-pay charge; (2) eighty-nine (89%) of Duquesne's stranded costs will be

recovered on a fixed (i.e. non-usage) basis; (3) the proposal shifts a substantial risk of the market transition to customers by eliminating any potential variability due to usage changes (recall that the reconciliation mechanism eliminates the variations in usage issue); (4) Duquesne is assured that half of its stranded costs is recovered on a risk-free, levelized basis greatly increasing its cash flow; and (5) the proposal inappropriately shifts the risk associated with the move to a competitive retail generation market from shareholders to customers for a substantial portion of Duquesne's future revenue requirement. DII St. No. 1 at 50-53.

B. Conclusion.

The Commission should calculate the CTC as noted above. In addition, the Commission should reject Duquesne's proposal to design the CTC on a two part basis. Such design is anticompetitive, inconsistent with a competitive market, inconsistent with the risk allocated to utilities and customers by the Legislature and the Act and would constitute poor public policy as the Commission attempts to move the Commonwealth toward a competitive retail generation market.

VI. Miscellaneous Issues.

A. Aggregation.

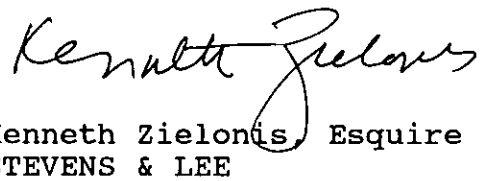
As PRA noted in its direct testimony, this Commission should insure and require Duquesne to permit aggregation of customer load. As indicated by PRA witness Albrecht, aggregation is a means of permitting smaller customers to replicate larger customers so as to attract the largest number of alternative, competitive generation suppliers for their service needs. A failure to require Duquesne to permit aggregation will frustrate the intent of the Legislature and the Act. Furthermore Duquesne should be required affirmatively to permit customers who have multiple sites to aggregate their load. That is, if a customer has the ability to switch supply between different sites in Duquesne's territory, it should be given that opportunity. Finally, the Commission should also require that the first electricity through the meter is that supplied by the alternative generation supplier. In this fashion the customer will receive the greatest benefit in the move to the competitive retail generation market. Furthermore, since at a future date (as implemented in the PECO case, probably two years from the ending of this proceeding) Duquesne will be required to fully unbundle its services and to require and to permit 100% direct access to the competitive generation market, now is the time to start that process to

determine whether the Commission must institute other items to insure a smooth transition to that market.

VII. Conclusion.

For all of the above reasons, the Pennsylvania Retailers Association respectfully requests this Commission to adopt each and every recommendation contained herein.

Respectfully submitted,



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Dated: February 10, 1998

Attorneys for the Pennsylvania Retailers Association

IN THE COMMONWEALTH OF PENNSYLVANIA
BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that, on this 10th day of February, 1998, I have served true and correct copies of the foregoing document upon the persons set forth below by First Class Mail, postage prepaid or by hand-delivery (unless service is otherwise indicated), in accordance with 52 Pa. Code Section 1.54:

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February 10, 1998

ORIGINAL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

KJR

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

Dear Mr. McNulty:

Enclosed please find two copies of the Environmentalists' brief in the above-captioned proceeding. I have also enclosed a computer diskette with the brief in electronic format.

The brief is being served on all parties of record in accord with the attached Certificate of Service.

DOCUMENT
FOLDER

Sincerely,

Roger E. Clark

Roger E. Clark
Attorney for the Environmentalists

Enclosures: Brief of the Environmentalists
computer diskette
Certificate of Service

Copies: Presiding Judge Corbett (w/ computer diskette)
All parties of record (w/o computer diskette)

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ORIGINAL

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

Brief of
The Environmentalists
and the
Low-Income Advocates

February 10, 1998

Attorney for the Environmentalists:

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Brief of the Environmentalists
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I. INTRODUCTION AND SUMMARY OF ARGUMENT

A. Environmental Issues

To the Environmentalists,[1] the goal of electric utility restructuring should be to create a new 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.[2]

Restructuring of the industry must do more than simply facilitate a mad rush for the next cheap kilowatthour. We need to direct the creativity and resourcefulness of a free and vibrant market to the task of lowering the price of electricity for Pennsylvania's citizens in their homes, businesses, factories and farms and to the challenge of reducing the serious environmental and health consequences of generating, transmitting and distributing electricity.

Today, those environmental and heath consequences are considerable. Electricity's fuel cycle is responsible for roughly two-thirds of our society's SO_2 emissions, nearly one-third of total NO_x emissions and more than one-third of

> "Using energy in today's ways leads to more environmental damage than any other peaceful human activity."
>
> *The Economist*, August 1991

[1]The Environmentalists consist of the Sierra Club, the Group Against Smog and Pollution (GASP), Clean Water Action, Citizen Power, the Pennsylvania Public Interest Research Group (PennPIRG) and Citizens Organizations on Utility Policies (COUP).

[2]This is the goal which begins *The Environmentalists' Vision for the New Electricity Marketplace.* This two-page document, drafted by the client group, is in this proceeding's record as Exhibit DS-2 of Environmentalists' Statement 1 (David Schoengold). The *Vision* document is included in this brief as Appendix A.

total CO_2 emissions, as well as a perilous list of hazardous, radioactive and solid wastes and liquid effluents.

The United States' effort to protect the environment has made significant strides, beginning with the major wave of federal environmental legislation was enacted in the early 1970's. Next came the federal Clean Air Act Amendments of 1992, which was a new approach for environmental protection, using allowance trading and other market-based strategies to further reduce emissions at a cost lower than the traditional diaper-on-the-smokestack style. In recent months, the momentum for change has accelerated again, with the U.S. Environmental Protection Agency's new regulations for nitrogen oxides and small particulates, the world community's commitment to binding reductions of carbon dioxide and other greenhouse gasses, and the President's proposal for a series of new tax breaks and other incentives for a variety of energy conservation and renewable energy technologies.

Unfortunately, except for some estimates of future environmental compliance costs buried in the printouts of market value projections, the various restructuring plans submitted by Pennsylvania's electric utilities are silent on the environmental implications of their proposals. The companies act as if environmental issues are not important to the restructuring debate. Instead, the epithet utilities now regularly use for environmental initiatives (and universal service programs and any other attempt to address a societal need or interest other than their short-term profitability) is to label the effort a "social" program. Fortunately, most people of Pennsylvania do not share these

views and they want policies which advance not only the economic self-interest of individual companies and consumers, but also the broader policy goals of our society.

These restructuring cases provide us with an important opportunity to set a better course to achieve these environmental goals. The best means to affect this change is in our treatment of stranded costs. This opportunity was eloquently described by Peter Bradford in his testimony in the PECO Energy restructuring case:

> Strandable investment is the public's best road to an effectively competitive and an environmentally acceptable future. Regulators, legislators and others in the public sector must not give it away until that future is well secured. The opportunity for recovery of a substantial amount of stranded costs should be expressly conditioned on full utility cooperation in achieving the best result for customers and the environment in the years ahead.[3]

The Environmentalists suggest that these restructuring cases, with their quantification and recovery of stranded costs, present us with the opportunity to forge a new deal with the utilities. If we the ratepayers agree to pay these stranded costs, what do we receive in return? What will we have to show for the payment of stranded costs in this proceeding? These are the questions the people of Pennsylvania should be asking the Pennsylvania Public Utility Commission (the "Commission").

As environmentalists, we have worked to include the environmental issues in the restructuring debate for the Duquesne Light Company ("Duquesne" or "Company"). The environmental recommendations we are making in this proceeding are:

---

[3]Application of PECO Energy Company for Approval of its Restructuring Plan, Docket No. R-00973953, CEPA *et al.* Statement of Peter Bradford, p. 13, l. 5-9.

1. Revise the CTC rate design to remove it from the fixed portion of rates and into the kilowatthour charges, so as not to promote sales and undermine consumers' incentive to conserve electricity.

2. Add reasonable interconnection standards for small self-generation, so such projects are not stifled by costs and bureaucratic hassles.

3. Add a net metering tariff for renewable energy projects and fuel cells of 10 kW or less.

4. Require all suppliers to tell consumers about air emissions, liquid effluents and radioactive, hazardous and solid wastes released to the environment by their generation of electricity.

5. Reduce the market domination of the monopoly utility by creating a supplier pool to serve non-choosing customers, so that customers who fail to choose do not all default to the monopoly utility.

6. Add a renewable energy pilot program.

7. Order a distribution system planning process with public involvement which evaluates the life-cycle costs of all system upgrade options, including energy conservation and efficiency, load management and distributed generation.

8. Expand the consumer education program to include the issues of the environmental consequences of energy production and use and the opportunities to reduce use through energy conservation and energy efficiency.

9. Add an energy loan program to help all residential customers finance improvements their energy efficiency, with an initial capitalization equal to 2% of the Company's stranded cost recovery.

10. Create a Sustainable Energy Development Fund to support renewable and clean energy projects, energy conservation and efficiency development, with funding ramping up to 1% of gross revenues.

11. Become a full partner in the U.S. Department of Energy's Million Solar Roofs Program and provide loans for photovoltaic installations at 0.5% above the Company's cost of money.

12. Require the Company and all electric generating suppliers selling power to Duquesne customers to upgrade their generating plants to current Pennsylvania new source environmental standards.

By making these changes, we will make an investment in a sustainable energy future and be on the road to adequate, safe, clean, reliable and efficient energy services at fair and reasonable prices and at the lowest long-term cost to society.

B. Low Income Issues

This brief is also submitted on behalf of the Low Income Advocates.[4] The Environmentalists join with their allies in the low-income community to voice their concern about how the poor will fare in the restructured market. Restructuring in other industries has not done a very good job of reducing costs and improving service for our most vulnerable citizens who, for a variety of reasons, may be unable to experience the benefits promised by restructuring. As low-income advocates, we urge the Commission to reject a number of elements of Duquesne's restructuring plan and to modify it in a number of important ways:

1. Ensure that Electric Generation Suppliers ("EGSs") do not engage in redlining, discriminatory and unfair credit policies and other tactics which prevent low-income households from securing electricity from an EGS.

[4]The Low Income Energy Advocates consist of the Mon Valley Unemployed Committee, Just Harvest, the Alliance for Progressive Action and the Rainbow/PUSH Coalition.

2. Evaluate the extent to which low-income households are able to participate in the new market.

3. Encourage aggragation of low-income households and other strategies to facilitate their participation in the market.

4. Expand the consumer education program to address the specific needs and concerns of low-income households.

5. Require LIURP funding to ramp up to 0.2% of system revenues.

6. Require CAP funding to ramp up to 0.5% of system revenues.

7. Ensure that universal service benefits are portable.

8. Recover universal service program costs from all customer classes, not just the residential class.

9. Create a Universal Service Program Advisory Committee so provide meaningful public input into program design and implementation.

10. Create a local Consumer Education Committee with responsibility and authority for the local education program.

11. Order a consumer education planning process as described in the testimony of Roger Colton and Barbara Alexander.

12. Require a four-year consumer education program budget equal to $5.00 per residential customer, of which 65% is allocated to the Commission's statewide program and 35% is allocated to the local education program.

C. The Three Tests

In evaluating the restructuring plan submitted by Duquesne and the alternative proposals made by the intervening parties, the Environmentalists urge the Commission to apply three tests. The first test is whether the offered proposal is in the public

interest. For the Environmentalists, the public interest is found in the answers to three questions: is it good for the consumer, is it good for competition, and most important for the Environmentalists, is it good for the environment?

By asking the first question, is it good for the consumer, we mean will consumers see a meaningful cut in electricity prices? Will the benefits of restructuring be shared by all customer classes? Will low-income consumers have access to essential electric services on reasonable terms and conditions and will they be able to participate in the new market? Will consumers receive the information and education they need to meaningfully participate in the new market?

The Three Tests

(1) Is the proposal in the public interest?
Is it good for consumers?
Is it good for competition?
Is it good for the environment?

(2) Is the proposal consistent with the Act?

(3) Are the rates and charges imposed by the proposal just and reasonable?

The second question under the public interest test is whether the proposal is good for competition. Pennsylvania will realize the benefits of restructuring only if the Commission succeeds in creating a robust and vibrant competitive marketplace. Do the unbundled energy prices allow for meaningful competition? Is the market domination of the monopoly utility constrained? Are fair rules developed and enforced which prevent restraint of trade and other practices? As one of the parties noted in its brief in the

retail access pilot proceeding, "[t]his Commission cannot take competition for granted"[5] and we are learning the truth of that statement more with each passing month. In evaluating the results of the Act and the Commission's implementation of it, people will look first and foremost to whether the Commission succeeds in producing a competitive market.

The third and final question of the public interest test is whether the proposal is good for the environment. Does the proposal help reduce adverse public health and environmental consequences of the production, transmission, distribution and use of electricity? Does the proposal support energy conservation and efficiency, renewable energy and other clean energy alternatives? Does the proposal advance a sustainable energy future for Pennsylvania?

The second test which the Environmentalists urge the Commission to apply in its decision-making is whether the proposal is consistent with the Electricity Generation Competition and Customer Choice Act ("the Act")[6].

The third test for restructuring proposals is whether the rates and charges imposed are just and reasonable. The Act did not repeal the Public Utility Code, it simply added a new chapter to the existing body of public utility law. The Code's standards of just and reasonable rates, used and useful and the other sections of the

[5]Docket P-00971168 *et al.*, Main Brief of Conectiv Energy (August 13, 1997), page 2. They note that despite the necessary legislative and regulatory actions, neither the telecommunications industry nor the natural gas industry has yet to experience successful competitive markets.

[6]66 Pa.C.S. §§ 2801 *et seq.*

Public Utility Code are still the law and these requirements apply to the new rates imposed by the restructuring plan.

The balance of this brief follows the generic outline drafted by the parties. Where the Environmentalists have chosen not to address an issue, the corresponding outline heading is left blank.

II. PHASE-IN OF CUSTOMER CHOICE

A. Method of Customer Selection

Duquesne proposes to allow customers access to the competitive market in three phases spread out over three years. The assignment of customers to one of the phases or groups (and thus the timing of the customer's ability to shop) is determined by geography for residential and small commercial customers and by Standard Industrial Code for large commercial and industrial customers.[7]

The Environmentalists prefer a first come/first served approach which allows customers to volunteer to shop. If too many residential and small commercial customers sign up for one of the phases, a lottery would be held to determine who is able to join. For large commercial and industrial customers, if the number of customers signing up exceeded the allowance, then each volunteering customer would be served

[7]Duquesne Statement No. 6 and 6-R (Frank Hoffman).

with a pro-rata share of their load. This approach was adopted by the Commission in the PECO decision[8] and we support it in this proceeding.

A robust competitive market will develop only if there is a significant number of potential customers. If an initial group of customers is offered the opportunity to enroll on the basis of zip code or SIC code, it is quite probable that many in the initial group would not enroll. To ensure a healthy number of market participants in the early years of competition, it is better to allow the early-adopters to self-select. The Commission adopted this same principle in the Retail Access Pilots proceeding[9] and it is sound policy for this proceeding as well.

B. Timetable for Phase-In

In its restructuring plan, Duquesne proposes to phase in customers in three equal segments over three years beginning January 1, 1999.[10] The Environmentalists prefer to see an accelerated schedule, where two-thirds of the customers are able to choose their supplier on January 2, 1999 and the final one-third are able to choose on January 2, 2000. This is the phase-in timetable which the Commission has ruled

[8]*Application of PECO Energy for Approval of its Restructuring Plan*, Docket No. R-00973953, Opinion and Order (entered December 23, 1997), pp. 46-48. Application of PECO Energy for Approval of its Restructuring Plan, Docket No. R-00973953, Opinion and Order on Reconsideration (entered January 15, 1998), p. 22.

[9]Petition for Approval of Retail Access Pilot Programs, Docket Nos. P-00971168 *et al.*,Opinion and Order on Pilot Program Implementation (entered August 21, 1997).

[10]*Duquesne Statement No. 6 and 6-R (Frank Hoffman).*

consistent with the Act and which was approved in the PECO decision.[11] *It makes good* sense in this proceeding because it ensures a large number of market participants in the critical first few years of the transition.

III. TRANSMISSION AND DISTRIBUTION RATES; UNBUNDLING ISSUES

G. Other Issues - Targeted Area Planning

As load grows, Pennsylvania's Electric Distribution Companies ("EDCs") will come under increasing pressure to upgrade transmission and distribution lines. However, before an EDC invests ratepayer money in such actions, it should first evaluate the life-cycle costs of a number of alternatives, including energy conservation and efficiency, load management and distributed energy generation. Integrated resource planning should be an important tool in the distribution segment of the electric industry.

Environmentalist witness David Schoengold recommends an "integrated" approach to distribution system planning that encourages the utility to identify and implement the least-cost option in meeting system requirements by finding the least-expensive solution to

The Regulation of the EDCs Should Facilitate Competition and Encourage Energy Efficiency.

[11]Application of PECO Energy for Approval of its Restructuring Plan, Docket No. R-00973953, Opinion and Order (entered December 23, 1997), p. 47. Application of PECO Energy for Approval of its Restructuring Plan, Docket No. R-00973953, Opinion and Order on Reconsideration (entered January 15, 1998), p. 22.

distribution system needs or problems.[12] Sometimes the least-cost way to solve a distribution problem is not by building new distribution facilities, but rather by targeting demand-side management approaches or by siting generation in local areas to avoid or reduce the need for distribution system upgrades. In other situations, the lowest cost method may be to reconfigure existing distribution facilities rather than build new ones. As Mr. Schoengold testified, automatically picking distribution system upgrades may well lead to higher costs to customers and negative environmental impacts.

Mr. Schoengold recommends a process for turning this common sense principle into a workable system for minimizing distribution system costs and environmental impacts. According to Mr. Schoengold, the Company should begin a systematic collection of data to support a thorough understanding of its distribution capabilities and limitations, forecasted needs and capital additions, area-specific avoided costs, and the costs and characteristics of a range of alternatives to traditional system reinforcements.

The Environmentalists also propose that this planning process be open to meaningful public review and input, including the right of discovery, technical meetings, hearings and a publicly published final plan. Such a planning process would facilitate distribution system investments which are good for the system, the economy and the environment.

[12]Environmentalists' Statement No. 1 (David Schoengold), p. 16, l. 20 to p. 18, l. 14.

IV. TRANSITION OR STRANDED COSTS

A. Overview of Stranded Cost Valuation and Recovery Approaches

1. Introduction

The Environmentalists contend that the Act sets up a five-step process for addressing stranded costs:

a. Quantification - determining the level of stranded costs.

b. Mitigation - working to reduce the level of stranded costs.

c. Sharing - a fair and reasonable sharing of the burden.

d. Allocation - designing a CTC recovery mechanism which properly assigns by class and within class.

e. Reconciliation - adjusting the CTC recovery for changes in sales, market price and other factors.

The quantification of stranded costs will be the linchpin of the Commission's restructuring order. A higher stranded cost award means a higher Competitive Transition Charge ("CTC") in the unbundled rates.[13] Because of the rate cap,[14] a higher CTC means a lower generation or shopping credit, which means that less of the bill is subject to competition and customers have less opportunity to obtain savings from alternate suppliers. This means that alternate suppliers have a tougher time entering

[13]Duquesne is not proposing to securitize any of its stranded costs, so there is no Intangible Transition Charge.

[14]66 Pa.C.S. §2804(4).

and staying in the market, robust competition fails to develop and the promise of the Act is unfulfilled.

These issues are important to the Environmentalists because the absence of competition will slow down the introduction of new, clean generating options (both fossil-fueled options and renewable resource options). In addition, a high stranded cost recovery will indirectly subsidize existing generation including older inefficient, polluting units. These emissions will make it more difficult to maintain air quality at levels sufficient to protect human health and property. This in turn may impose restrictions on economic development, constraining the siting of manufacturing operations or competitive power producers. How the Commission treats stranded costs will have a very large impact on the fate of the current generation of polluting and unsafe generating plants and whether and when Pennsylvania moves to a new and healthier electric future for our children.

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

1. Introduction

Approximately 64% of Duquesne's total stranded cost claim is its calculation of $1.916 billion of stranded generating assets.

The Environmentalists agree with Duquesne that it is not possible to determine and fix the level of stranded cost at this time. We do not know what the true market price for power is today because we do not have a competitive market for power. To

say we can project a reasonable market price for electricity for 30 years into the future is just short of madness.

Duquesne instead proposes a methodology which makes an initial quantification of market price and stranded costs, and then revisits the issue in a second quantification expected to occur in 2002 or 2003. This approach makes sense, but we have serious problems with several of the details.

First, the Environmentalists have serious concerns about Duquesne's methodology for determining the annual market price of electricity by auctioning off a small block of power and using the auction price as that year's market price. Since the annual power sale will be for only a portion of Duquesne's power, it is not clear how well the sale price will reflect the overall market price.

Also, because the power sale will take place in the context of a mixed competitive/regulated market, it is unlikely that the price will accurately reflect a true market price. As long as buyers and sellers in the marketplace are receiving stranded cost recovery in a regulated setting, it is likely that the market price will be artificially low. If utilities were not allowed recovery of stranded cost, then the price which developed in the competitive marketplace would be a true market price, but the act of setting a stranded cost level determines the market price. In the presence of stranded cost recovery, a true market price is unlikely to develop.

The second objection is that the second-phase valuation, scheduled to occur in 2002 or 2003, is not described well in Duquesne's filing and there is little assurance that

absent a total divestiture, we will be any more able to determine the true market value then than we are today. If Duquesne's shopping credit is accepted, the Environmentalists doubt that much of a competitive market will develop until the CTC ends and we will face as much uncertainty in 2002 as we do now. The proposal to sell a small slice of generation to set the market value of all of Duquesne's generating plant is not the correct approach.

D. Decommissioning

1. Nuclear Decommissioning

a. Introduction

The operating licenses of Duquesne's three nuclear units will expire in 2016 (Beaver Valley I), 2026 (Perry I) and 2027 (Beaver Valley II). The Company estimates that its total nuclear decommissioning obligation is $312 million, of which only $34 million is funded.[15] Duquesne proposes to continue to collect $9 million per year towards its nuclear decommissioning obligation as part of its stranded cost recovery, and in January, 2006, the unfunded balance will be treated as "a reduction in any residual value of its generating plant.[16]

[15]Duquesne Statement No. 4 (Morgan O'Brien), p. 17. The costs are year-end 1996 expressed in year-end 1996 dollars.

[16]Duquesne Statement No. 4 (Morgan O'Brien), p. 17.

The Environmentalists' witness Bruce Biewald[17] suggested that the goals for the Commission's nuclear decommissioning funding policy should be:

(1) ***adequacy*** of the funds to decommission the plants in a safe and timely manner;

(2) ***equity*** between customers and shareholders, and across generations; and,

(3) ***efficiency***, provided by a framework giving the plant operator responsibility for some portion of the decommissioning costs as an appropriate incentive to control the costs of the decommissioning project.

b. The Problem of Uncertainty

Dismantling large, highly radioactive nuclear units is a large, complex undertaking for which experience is currently quite limited, and regulations continue to evolve. It is not possible now to produce an accurate estimate for the cost of decommissioning Duquesne's nuclear capacity. Any current estimate of nuclear decommissioning costs is subject to considerable uncertainty -- technical, economic and regulatory. In addition, the possibility of nuclear plant shutdown prior to the license termination date is a major concern because decommissioning funding is based upon the full license period. If a nuclear unit is retired prior to the license termination date, there will be a funding deficiency, in some cases of considerable magnitude. Several nuclear units have shut down already prior to the end of their 40 year Nuclear

[17]Environmentalists' Statement No. 2 (Bruce Biewald), p. 30, l. 8-13.

Regulatory Commission license and further shutdowns are likely as nuclear plants are increasingly subjected to market forces.

The nuclear decommissioning cost estimates for dismantling a large pressurized water reactor are about 600% higher (in real dollars) today than they were in 1976, with the cost estimates doubling every seven to eight years.[18]

c. The Need for an Incentive to Control Costs

To quite an extent, nuclear decommissioning costs are within the control of the plant owner. There is a clear relationship between routine plant operation and future nuclear decommissioning costs. Running the plant today in a very clean manner (e.g., regular decontamination of equipment, removal of radioactive waste, etc.) will somewhat increase current operation costs, but lower decommissioning costs. Moreover, good planning and cost control measures for the decommissioning process that reduce the total exposure for decommissioning would translate into stranded cost reductions.

Unfortunately, Duquesne has offered no evidence that it has a program in place to minimize the cost of its nuclear de-construction program. While the Environmentalists fully support the principle that adequate funds be made available to decommission the plants in a safe and timely manner, the ratepayers need the Company to *minimize* these costs to the greatest extent practicable.

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[18]Environmentalists' Statement No. 2 (Bruce Biewald), p. 32, l. 33-37 and p. 33, l. 20-21.

The Environmentalists believe that it is unreasonable to have the wires charge be the sole means for funding the Company's nuclear decommissioning obligations. This would provide a subsidy to the continued operation of the plant and remove all incentives for Duquesne to control future decommissioning costs. Customers should not be saddled with an open-ended obligation to bear all of these costs. Instead, the Commission should adopt a framework for decommissioning in which the risks are shared between the Company and its customers. While it may be reasonable to fund some portion of decommissioning costs through the CTC, the Commission should consider the problems that occurred in the past when cost-based regulation was applied to the large, complex, expensive and uncertain project of nuclear plant construction.

d. The Need for Mitigation of Decommissioning Costs

The Environmentalists contend that Duquesne has not addressed the issue of stranded cost mitigation as it relates to nuclear decommissioning, and that the Commission should require a plan for and evidence of such mitigation prior to approving CTC recovery of stranded costs. Duquesne's decommissioning obligation as currently forecast by the Company is large. It could be larger still, with further increases in nuclear decommissioning cost estimates and further requirements for spent fuel storage and disposal. Therefore, we believe the Act requires Duquesne to undertake clear and significant efforts to mitigate its future nuclear stranded investment.

Since decommissioning is a process that hasn't taken place yet, there are opportunities for mitigation that are not possible for some other stranded costs. For example, good planning and cost control measures for the decommissioning process that reduce the total cost exposure for decommissioning would translate into stranded cost reductions. There is no evidence of a comprehensive Duquesne program to minimize the cost of this de-construction program. This would be hands-on mitigation, not *just shifting* costs in time or among the various parties.

Another mitigation strategy would be accelerating decommissioning funding in order to reduce the fund deficiency. The Company could contribute shareholder dollars to the fund, further reducing the deficiency.

The Commission should require Duquesne to develop a plan for the mitigation of its decommissioning costs.

e. The Need for a Generic Proceeding on Nuclear Decommissioning

The Environmentalists urge the Commission to address the complicated technical and policy issues of nuclear decommissioning in a generic case, in which limited regulatory resources can be used efficiently and a consistent statewide policy can be fashioned. These issues have not gotten the attention they deserve in the restructuring proceedings, and just as it did for the issues of Code of Conduct, universal service and consumer education, a generic proceeding makes good sense for nuclear decommissioning costs. In this proceeding, the Commission could evaluate the amount

of decommissioning cost that is dependent upon continued operation of the plants; the degree of uncertainty in the current decommissioning estimates; the activities and costs that are in the "grey area" between nuclear decommissioning and plant operations; and related issues.

f. The Need for an External Fund

The possibility of early retirement of Duquesne's nuclear stations must be taken into consideration in the design of decommissioning funding plans. Widespread discussion has occurred debating the effect that electric restructuring and competition will have on nuclear power plants. The financial difficulty that a company could then experience from a retiring plant's loss of income is a persuasive reason for the maintenance of an external fund for decommissioning.[19] Restrictions should be placed upon the use of the decommissioning funds and Commission jurisdiction should be preserved.

g. The Need for Cost-Benefit Analysis

Any proposed increases in customer payments should trigger a cost-benefit analysis justifying the cost increase. In the event that Duquesne requests an increase in decommissioning funding, it must demonstrate, as a material proposition in its claim, that the increase is consistent with an overall economic plan for the unit. For example,

[19]Environmentalists' Statement No. 2 (Bruce Biewald), p.7.

if the Company plans to continue operating the unit for which the funding increase is requested, then it should present a cost-benefit analysis that shows that continued operation, with the increased decommissioning funding levels, is the economic course of action.

h. Spent Nuclear Fuel and Radioactive Waste

The treatment of spent nuclear fuel should be clarified and adjusted. Not unlike the removal and disposal of ash from coal-fired units, the handling, storage and disposal of spent fuel rods at nuclear generating stations are a part of ongoing operations and maintenance and should be treated as such by the Commission.

With regard to low level radioactive waste storage, the Environmentalists are concerned that the rate treatment proposed by Duquesne creates incentives for excessive storage of waste on site.

F. Recovery of Stranded Costs

2. Proposals to Adjust the Level of Stranded Cost Recovery

a. Mitigation

The Act imposes upon the utilities the undeniable responsibility to mitigate their stranded costs. The definition of "transition or stranded costs" are certain costs "which the commission determines will remain following mitigation by the electric utility."[20]

[20]66 Pa.C.S. §2803, definition of "Transition or stranded costs.".

Another section of the Act directs the Commission to consider "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..." and cites several specific mitigation strategies which should be considered.[21] It is interesting to note that the mitigation must be "commensurate with the magnitude of the ... stranded costs" and that the duty to mitigate exists not just up to the filing of the restructuring plan, but extends throughout the transition period.[22]

One proven mitigation strategy which Duquesne has reduced rather than expand in the recent past is demand-side management. Energy conservation and load management mitigate stranded costs because they reduce the retail allocation of Duquesne's stranded generating assets by reducing net retail peak load and freeing up capacity and energy for wholesale transactions.

b. Sharing of Stranded Costs

One of the policy declarations contained in the Act is that:

> [i]n moving toward greater competition in the electricity generation market, the Commonwealth must resolve certain transitional issues **in a manner that is fair** to customers, electric utilities, investors, the employees of electric utilities,

[21]66 Pa.C.S. §2808(C)(4). This is another reason to recommend the trading account mechanism for the quantification of stranded costs.

[22]66 Pa.C.S. §2808(C)(4).

> local communities, nonutility generators of electricity and other affected parties.[23] [emphasis added]

The legislative history is clear that there is no utility entitlement to 100% recovery of its stranded investment. In the Senate debate on the Act that occurred on November 25, 1996, Senator Piccola cited with favor a November 14, 1996 letter from Irwin A. Popowsky, Consumer Advocate which stated that under the Act, the burden of stranded costs would be "shared" by the utilities and the customers. The OCA letter emphasized that:

> [i]t is extremely important to note that utilities are not guaranteed full stranded cost recovery under this bill. With respect to utility-owned and operated generation facilities, the PUC must determine the appropriate level of stranded costs that is just and reasonable to recover from ratepayers...[24]

While recognizing nothing prevents a utility from requesting 100% recovery of its stranded costs, he stated that the utility may only recover its stranded costs "to the extent that the PUC determines it to be just and reasonable."[25]

Senator Brightbill also confirmed this recognition that the Act did not guarantee utilities a 100% recovery of their stranded investment: "... in California they guaranteed the utilities a 100-percent return on their stranded investment. Here we make no such *guarantee*."[26]

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[23]66 Pa.C.S. §2802(8).

[24]Legislative Journal – Senate, 11/25/96 at 2688.

[25]Legislative Journal – Senate, 11/25/96 at 2688.

[26]Legislative Journal – Senate, 11/15/96, at 2692.

Addressing this theme of a fair sharing of the responsibility, Environmentalists' witness David Schoengold testified:

> The amount of stranded generating assets represents a large economic loss. There are large amounts of wasted dollars which will not produce anything of value, but must be dealt with. I do not believe it is correct to hold the customers entirely responsible for this loss. To do so would be to treat the stockholders as if there were no economic loss at all. I believe a sharing of the economic loss is appropriate.[27]

For his testimony in this proceeding, Mr. Schoengold developed a model which examines depreciation, remaining rate base and the year-by-year returns on rate base. The stockholders' initial investment in the generation assets was $835 million ($2.084 billion of production plant *x* the equity fraction of 40.1%). Noting that stockholders receive a significant portion of their investment back through already-booked depreciation, he estimated that Duquesne stockholders have already recovered 41% of their investment in generating plant, for a depreciation recovery of $342 million.[28] Mr. Schoengold's simple return model shows that when Duquesne's accumulated depreciation has reached 41% of the initial investment, the authorized returns on investment have totaled 126.5% of the initial investment.[29] The total authorized returns have thus been $1.057 billion ($835 billion *x* 126.5%) and the total dollars to Duquesne stockholders (depreciation plus return) have been $1.4 billion (recovered depreciation

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[27]Environmentalists' Statement No. 1 (David Schoengold), p. 19, l. 25 to p. 20, l. 3.

[28]Environmentalists' Statement No. 1 (David Schoengold), p. 20, l. 19-21.

[29]Environmentalists' Statement No. 1 (David Schoengold), Ex. DS-3.

of $342 million + return of $1.057 billion). The internal rate of return of their investment to date has been approximately 8.8%.[30]

Mr. Schoengold then went on to analyze the level of stranded generating asset cost recovery which would be necessary in order for the shareholders to continue a 9% rate of return through the end of the transition period, ie. to do as well in the transition period as they have done to date. He determined that a stranded generating asset recovery fraction of 60% was adequate to pay off the debt holders and to provide the stockholders with a return of their investment and a 9% return on their investment.[31] Mr. Schoengold calls this "a reasonable return ... on bad investments ..." By limiting the stranded generating asset recovery to 60%, the customers should have an opportunity to see real reductions in their cost of electricity.

In rebuttal to Mr. Schoengold's methodology and recommendation, Duquesne witness Mr. Clayton argued that:

> Mr. Schoengold's analysis must be rejected because it attempts to carve out specific assets and assess whether or not investors have received a hypothetical return. This carving out of specific assets to assess investor returns is preposterous. Investors invest in the Company as a whole and intend to earn overall return. It is not possible to credibly remove any particular group of assets from the Company to assess whether or not investor's [sic] have been fairly treated.[32]

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[30]*Environmentalists' Statement No. 1 (David Schoengold)*, Ex. DS-4.

[31]Environmentalists' Statement No. 1 (David Schoengold), Ex. DS-5.

[32]Duquesne Statement 2-R (Donald Clayton), p. 43, l. 6-13.

In his surrebuttal testimony, Mr. Schoengold agreed that stockholders invest in a company as a whole and not in individual assets, but noted that:

> "... the perspective of the Public Utility Commission is quite different from that of the stockholders. The PUC makes judgments on individual assets all the time. If an investment is disallowed, this is a judgment on an individual asset. If a rate case is delayed, the assets added since the determination of the rate base in the last rate case are treated differently than those already in the rate base. As a result, the return on investment on the rate base is hardly ever the same as the return on investment in the entirety of the utility's capital.
>
> As another example, when utility assets are treated as below-the-line investments, the treatment of those assets is different than above-the-line investments. To take this example even further, in the case of a utility owned by a holding company with no public ownership of the utility stock (but, instead, only public ownership of the holding company), stockholder return on investment is only indirectly related to return on the regulated utility portion of investment. I believe the evidence is clear that stockholders can deal with the situation of differential treatment of different portions of their investment.
>
> Thus, the approach I recommended in my direct testimony is based on common practice.[33]

The Environmentalists argue that Mr. Schoengold presents a reasonable and proper approach to the issue of sharing stranded generating assets. He contends that the stranded generating asset recovery should be no larger than needed to provide the shareholders with a return of their investment in Duquesne's generating plant and a reasonable return on that investment. No one has disputed Mr. Schoengold's

[33]Environmentalists' Statement No. 1-S (David Schoengold),p.1, l. 16 to p. 2, l. 17.

testimony that this would occur if only 60% of the generation assets are included in Duquesne's stranded costs.

3. Methods of Stranded Cost Recovery

c. Rate Cap/CTC Extension

The Act provides for the CTC collection period to on December 31, 2005,[34] Since the CTC charge is a stone around the necks of ratepayers and a distortion of the true competitive market, it should be with us no longer than necessary. As David Schoengold testified:

> The purpose of the Competition Act is to bring the benefits of competition -- reduced costs -- to customers. Customers will receive no such benefits as long as the CTC is in place, since the CTC essentially negates any of the benefits of competition.[35]

Duquesne proposes CTC collection to end on December 31, 2005, and is not requesting that the statutory period be extended. Because Duquesne is not proposing any rate relief for its customers during the CTC collection period, it is especially important that the CTC collection not be extended.

[34]66 Pa.C.S. §2808(b). A longer recovery period is permitted for "good cause."

[35]Environmentalists' Statement No. 1 (David Schoengold), p.14, l. 22-25.

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 unbundling of rates is where the rubber meets the road for the ratepayers, for this tells customers how much of their bill they can take shopping for alternative suppliers. The generation or shopping credit is the most critical number in the unbundled rates to both the ratepayers (because it is the amount they can take shopping to find a lower price from another supplier) and for the alternate suppliers (because the degree to which they can undercut the generation credit will determine to a very large extent their ability to attract customers). Without a healthy shopping credit, shopping will not produce meaningful savings for customers, customers will not shop, EGSs will not find customers and will not survive. Suppose they had a market and nobody came.

Duquesne's unbundling methodology pays off the CTC at the expense of the shopping credit. The Company calculates the transmission charge, the distribution charge and the generation charge and then the entire remainder up to the rate cap is considered the CTC. The Environmentalists oppose this methodology and instead support the approach taken by the Commission in the PECO Energy restructuring Order which instead computed the CTC and left the shopping credit as the residual.

The Environmentalists contend that once the stranded cost level is determined by the Commission, it is then a straightforward task to determine the unbundled CTC.

The allowed level of stranded costs, plus the return allowed on those stranded costs, should be amortized over the seven-year recovery period specified in the Act (1999 through 2005) using the utility's cost of money. A reasonable assumption for expected load growth over that seven-year period should be used to determine expected annual sales. The system-average CTC per kWh is simply the stranded cost recovery in each year divided by the expected sales in that year.

There are several problems with the Duquesne methodology. First, by having the CTC expand to the rate cap, Duquesne provides no savings to customers, which we submit was the primary purpose of the Act. Second, the Duquesne methodology discourages competition because it results in a low shopping credit.

2. Other Conceptual Disputes

c. Levelized CTC v. Other Methods

The Environmentalists contend that the Act implies straight amortization of stranded costs.[36] Reconciliation should be structured to recover the stranded costs in equal annual amounts. This will conform to §2808(f) and will most closely resemble the market, where prices fluctuate because of natural market conditions but not because of a misplaced attempt to engineer rates. The Environmentalists recommend that the CTC recovery be equal throughout the collection period, and because of the assumption of a

[36]66 Pa.C.S. §2808(f).

slight load growth, the kilowatt-hour CTC charge should be able to decrease slightly over time.

d. *Duquesne's Rate Redesign Proposal*

The Environmentalists oppose the rate redesign proposal which Duquesne has attempted to insert into its restructuring plan. Duquesne proposes to shift costs from volume-based charges to fixed customer charges. We oppose this change for several reasons.

First, in rate cases where the utility wants to completely redesign rates away from the rate design principles which have been followed for a long period of time, the general rule is that extensive and detailed studies are require to justify the change. The justification provided in this docket would not be adequate to support such a major change in rate design if this were a rate case. The restructuring docket should not be used as an opportunity for Duquesne to implement rate design changes without proper and adequate scrutiny.

Second, this new rate design is a promotional rate which will encourage the sale of additional electricity and discourage energy efficiency and conservation. The use of a fixed charge serves to artificially reduce the cost of electricity the more a customer purchases.

Third, the use of a fixed charge causes the burden of stranded cost recovery to disproportionately affect low energy users and low-income customers, thus causing an intra-class shifting of rates.

The Environmentalists recommend that the Commission reject this rate *redesign* as unsound and inappropriate and require the Company to structure the CTC on a mils/kWh basis. The Company can insure against the risk of under-collection by implementing a true-up at the end of each year.

For the same reasons, the Commission should reject any proposal to collect transmission and distribution costs on a fixed charge rather than a per kWh basis.

e. Other Conceptual Disputes

(1) *Reconciling on the Basis of Market Price*

True reconciliation of the CTC require reconciliation of the difference between the projected market price and the actual market price. The Environmentalists have already address the weaknesses of Duquesne's proposal to fix a market price by selling a block of power each year on the open market.

(2) Reconciling on the Basis of Sales

To avoid an over-recovery of stranded costs, the CTC should be reconciled to reflect changes in sales. Because the CTC are charges added to each kilowatthour, the total CTC recovery is directly dependent on the number of kilowatt-hours sold

throughout the collection period. Even a very small discrepancy between projected sales and actual sales will result in a large difference in collections. The Act directed the Commission to "establish procedures for the annual review of the competitive transition charge" and to "reconcile the annual revenues received from the charge" at the approved level[37] and it should do so.

(3) Reconciling without Cost Shifting

In designing the reconciliation mechanism, it is critical to prevent cost shifting between customer classes. The CTC should be assigned to each class and reconciliation should occur within each class.[38] This is important because of the different growth rates for the different classes. For example, if high growth is experienced in the residential class, and low growth in the industrial class and reconciliation was calculated on a system-wide basis, CTC recovery would be shifted to residential customers from the industrial customers.[39] With reconciliation by class, the residential CTC charge under this scenario would be reduced or shortened (to reflect the faster recovery) and the industrial CTC charge would be increased or lengthened (to make up for the under-recovery).

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[37]66 Pa.C.S. §2808(f).

[38]This position is shared by others. See OCA Statement No. 4 (Lee Smith), p. 11-12.

[39]This hypothetical is exactly what has occurred this decade. The residential and commercial classes have experienced load growth, but the industrial class has seen a drop in number of customers, peak load and energy consumption.

VII. SPECIAL CUSTOMER CLASSES

C. Self-Generation

1. Distributed Energy

The Act appears to envision an energy future which is very similar to today's world, in which the generation of electricity is dominated by large central-generating stations. The Environmentalists have advanced a different view that our generation future will be marked by more decentralized, distributed systems. The challenge facing us is to design a marketplace which can accommodate not only the large central plants, but also the energy future of small turbines, roof-shingle photovoltaics and dishwasher-size fuel cells. We need marketplace rules which allow these new distributed energy sources.

2. Interconnection

Small distributed energy projects which face endless interconnection obstructions and high fees will never succeed. To remove unnecessary barriers to interconnection, the Environmentalists recommend several changes to the connection provisions of the tariff. First, the technical standards should be simplified and made consistent with IEEE, UL and other national standards. Second, for photovoltaic and other simple systems, the engineering review should be replaced with an inspection designed to confirm that the systems meet IEEE and UL standards and the cost of this review should be capped at $35. The interconnection review fee for other installations

should be capped at $250. Third, the tariff should allow a customer three metering options at the customer's choice: a non-ratcheted bidirectional meter; two meters; or a smart meter. There should be no additional meter-reading fee.

3. Net Metering

Duquesne currently does not have a net metering tariff. The Environmentalists recommend that, as a condition for receiving stranded cost recovery, Duquesne should implement a net metering tariff for renewable energy and fuel cell projects by any customer class which are 10 kW or less. In addition, the net metering provisions should specify retail-in/retail-out up to net each month and customers should be able to carry forward a generation credit (at the retail-out rate) for up to 12 months. The net metering provisions must address what happens when the customer is purchasing power from an alternate supplier.

IX. DUTY TO SERVE

B. Provider of Last Resort / Default Supplier

1. Introduction

A just and reasonable set of unbundled rates is an essential condition to creating a robust competitive market, but an adequate generation credit alone is not enough to ensure all customers have meaningful choices of electricity suppliers and services. The Commission must also address the problem of market domination by Duquesne by

virtue of its status as the monopoly supplier in this region for the last century. As Environmentalists' witness Bruce Biewald testified,

> A great many of Duquesne's electricity customers are unlikely to make any choice at *all* regarding their electricity supplier... If the Company is designated the default supplier of these customers, then it will be granted a significant market share without incurring the marketing and transaction costs that would be required of competitive utilities. This formidable advantage would add to the numerous tangible and intangible competitive advantages that are typically enjoyed by incumbent utilities.[40]

To address the problem of market domination by Duquesne, the Environmentalists proposed a system for allocating non-choosing customers to alternative suppliers serving Duquesne's service territory. We call this the Better Choice Plan.[41]

Before reviewing the specifics of this proposal, it is important to understand the distinction we are making between the concepts of "provider of last resort" and "default supplier." The provider of last resort is the "entity that is assigned the responsibility of ensuring that all electricity customers will have access to a reliable supply of electricity at reasonable prices, terms and conditions."[42] The provider of last resort is required to serve customers who, for a variety of reasons, cannot obtain generation services from any alternative supplier. The Act makes the electric distribution company the provider

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[40]Environmentalists' Statement No. 2 (Bruce Biewald), p. 9, l. 9-18.

[41]The genesis of the Better Choice Plan was the experience in the long distance telephone industry, where the Federal Communications Commission in 1985 sought to end the market domination of AT&T and encourage meaningful competition by setting up a market allocation pool of other carriers to provide long distance service to customers who failed to select a carrier.

[42]Environmentalists' Statement No. 2 (Bruce Biewald), p. 56, l. 21-23.

of last resort[43] and provides a funding mechanism to cover the cost of those services for those unable to pay.[44] The Environmentalists recommend that Duquesne be the *provider of last resort.*

The Better Choice Plan introduces the concept of "default supplier" which is very different than the provider of last resort. The default supplier is the supplier that serves the default customers, or those customers who are eligible to choose an alternative generation supplier but have failed to do so. Under the Environmentalists' Better Choice Plan, a more diverse market is created because the alternative suppliers active in the market can volunteer to become part of the default supplier group which will serve the customers who fail to choose.

Default Supplier
≠
Provider of Last Resort

Before describing the mechanics of the proposal, two other concepts must be addressed - the default customer and the default supplier group.

2. The Default Customer - The Failure to Choose

It is widely acknowledged that when an industry moves from a regulated monopoly to an open market, many customers stay with the monopoly supplier. Some argue that these customers are "choosing not to choose" and that it is inappropriate to

[43] 66 Pa.C.S. §2807(e).

[44] 66 Pa.C.S. §2804(8) and (9).

interfere in this "choice." But Environmentalists' witness Roger Colton showed the error in this argument:

> Consumer choice implies that given an opportunity, a consumer will use his or her knowledge of available alternatives to translate wants into satisfaction.
>
> In fact, however, considerable consumer research finds that there is no conscious exercise of discretion in the failure of consumers to choose an alternative supplier of service when an industry moves from a regulated monopoly to a competitive model. Indeed, "staying put" is the antithesis of exercising discretion. It is the failure to choose.[45]

Mr. Colton suggested three reasons why many customers fail to choose and noted that the Better Choice Plan promoted competition by helping customers overcome all three barriers:

> In each case, jump-starting the competitive electric market will help address the factors that led to the consumer paralysis in decision-making. Allocating the non-choosing consumers among alternative suppliers will help generate consumer experience that will overcome confusion and skepticism. Allocating consumers among alternative suppliers will help generate experience in seeking out and understanding information. Allocating consumers will help overcome the simple consumer inertia that leads to a consumer failure to act.[46]

Mr. Colton testified that a transitional market mechanism such as the Better Choice Plan was an appropriate and helpful response to these temporary customer difficulties.

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[45]Environmentalists' Statement No. 3 (Roger Colton), p. 2, l. 22-28.

[46]Environmentalists' Statement No. 3 (Roger Colton), p. 3, l. 26-32.

3. The Default Supplier Group

Under the Environmentalists' Better Choice Plan, suppliers can volunteer to participate in the default supplier group if they agree to seven conditions. These conditions, listed in the box below, are designed to protect the customers and to advance some important public interest goals. This *quid pro quo* is fair and appropriate because participation in the group is entirely voluntary and the participating suppliers receive from the Commission the private benefit of an allocation of default customers without incurring the costs and effort to recruit these customers.

The Environmentalists' Recommended Public Interest Standards for Participation in the Default Supplier Group

1. *The price for the generation services will be no higher than the unbundled generation rate that* Duquesne will be allowed to charge.

2. Any default customer who elects to switch generation suppliers will not be charged a contract termination fee or other penalty.

3. The energy and capacity to serve default customers meets an environmental baseline comparable to the applicable Pennsylvania environmental regulations.

4. The resource mix includes at least one percent renewable resources and the supplier has a net metering tariff and other policies to facilitate the interconnection of small-scale clean and renewable energy generation.

5. Customers would be informed about the fuel mix, air emissions and other wastes (radioactive, solid and liquid) of all of its power sold in Pennsylvania, in a simple, uniform format.

6. The generation supplier would contribute 0.5 percent of its total Pennsylvania power revenues to the Pennsylvania Sustainable Development Fund.

7. Customers would be informed about the number and percentage of its work force that is employed in Pennsylvania.

4. Allocating Default Customers

The Environmentalists' Better Choice Plan begins with customers selecting their generation suppliers, just as they would under the Act and the other proposals.[47] At no time does the Better Choice Plan interfere with any election by any customer to be served by a particular supplier. A customer will always be able to select a particular supplier and that selection will prevail. A reasonable time following the expansion of eligibility to each new group of customers, the results of the selection process will be published and evaluated to determine Duquesne's share of the customers.

For purposes of measuring Duquesne's market share, the Duquesne share would be defined to include (1) the customers who had made an affirmative selection of Duquesne, (2) the customers who had made an affirmative selection of one of Duquesne's affiliated generation suppliers,[48] and (3) the default customers (*i.e.* those who failed to make any selection at all). If the Duquesne share is less than 50%, nothing further would happen under the Better Choice Plan. The 50% figure is used as a threshold to identify the point at which Duquesne's market share threatens the health of the competitive market. If that share is less than 50%, then the remedy of the Better Choice Plan is unneeded. If the Duquesne share is 50% or more, then the Better Choice Plan's allocation mechanism would be triggered.

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[47]The mechanics of the Better Choice Plan are discussed in Environmentalists' Statement No. 2 (Bruce Biewald), p. 44, l. 33 to p. 49, l. 27.

[48]Because of the competitive advantage a supplier affiliated with Duquesne would have over other competitors (simply because of the affiliation), the Environmentalists suggest that for purposes of the market share determination, the customers of a Duquesne affiliate be considered Duquesne customers. These affiliates would not be eligible to participate in the default supplier pool.

When the Duquesne share is 50% or more, the Better Choice Plan would allocate all default customers to be served by the default supplier group. The default customers would be allocated on a random basis between the suppliers in the default supplier group in proportion to the market share of each member supplier.

The Environmentalists acknowledge that implementation of the Better Choice Plan is possible only after additional work to address some of the unresolved issues, but we urge the Commission to include it in the final Order to prevent the serious threat of market domination by the monopoly provider which would be fatal to the emergence of a competitive market.

X. UNIVERSAL SERVICE AND ENERGY CONSERVATION

A. *Introduction*

As noted in the Act, electricity has become a necessity of life,[49] but for many of Duquesne's low-income customers, it is a necessity they cannot afford. Unfortunately, this situation is not going to get better under restructuring. As Roger Colton testified for the City of Pittsburgh,

> [m]oving to a competitive marketplace in the electric industry will likely have significant adverse impacts on low-income consumers. A review of competitive, non-electric industries (such as health care, personal lines of insurance, telecommunications) reveals that, even if regulated, these industries have not achieved and maintained universal service. Universal service is *not* the norm in these industries

[49] 66 PA.C.S. §2802(9).

> and the competitive market has operated to impede rather than to promote universal service. In each instance, it tends to be the poor and minority consumers who are charged higher rates, provided lesser service or excluded from the market altogether.[50]

In implementing electric restructuring in Pennsylvania, we must all work to avoid this deterioration of service.

B. Overall Funding and Rate Issues

1. Eligibility and Funding Levels

The Environmentalists contend that the most serious deficiency in the Duquesne universal service program is that it imposes improper eligibility criteria which greatly decrease the number of households which are to be served by the programs. The eligibility guidelines in the Commission's Guidelines for Universal Service and Energy Conservation Programs begin with the statement that:

> [i]n general, these universal service and energy conservation programs shall be available to electric customers whose household income is at or below 150% of federal poverty guidelines and who meet other non-income criteria.[51]

The Guidelines go on to specify the "other non-income criteria" which are to be applied for each of the various programs. For example, the non-income criteria for the

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[50]City of Pittsburgh *et al.* Statement No. 2 (Roger Colton), p. 3, l. 12-20.

[51]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Appendix B, Section C(1), p. 31. The eligibility guideline allows up to 20% of the total universal service program budget to be applied to special needs customers with income between 150% and 200% of the federal poverty guidelines.

Customer Assistance Program (CAP) consists of one criteria: that the CAP applicant is "payment troubled," which the Guidelines define as "a household who has failed to maintain one or more payment arrangements."[52] For the Low-Income Usage Reduction Program (LIURP), the one recognized non-income criteria is that the household must have "high energy usage," which each LDC is allowed to define.[53]

Duquesne's Universal Service and Energy Conservation Plan[54] violates these Guidelines by adding additional eligibility criteria for each of its programs. Duquesne's CAP imposes the additional non-income requirements that the customer has lived at their current address for one year, has housing expenses more than 45% of their gross income and has a bill arrearage of at least $500. Duquesne's LIURP imposes the requirement that the customer has lived at their current address for one year.

The result of these added eligibility requirements is to greatly reduce the number of households who are eligible to receive assistance. Duquesne states that they have "identified 115,055 customers who are 'low-income, payment troubled.'"[55] Since those are the eligibility criteria the Guidelines have made applicable for CAP, the number of Duquesne customers who are eligible for CAP should be 115,055. But Duquesne

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[52]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Appendix B, Section C(2)(c), p. 33.

[53]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Appendix B, Section C(2)(b), p. 32. Duquesne defines high usage as 125% above the average customer usage.

[54]This document was attached as Exhibit JPF-1 of Duquesne Statement No. 14-R (Joseph Flynn).

[55]Duquesne Statement No. 14-R (Joseph Flynn), p. 8, l. 8-9.

states that only 5,731 customers "appeared eligible" for CAP.[56] Their additional eligibility criteria improperly rejects 95% of the eligible households.

The corresponding numbers for LIURP are unknown, since the Duquesne plan does not identify the number of "low income, high usage" customers. The number of customers estimated to be eligible for LIURP is 21,226.

When various parties pointed out this problem, Duquesne responded with testimony from Joe Flynn that:

> [n]either the Competition Act nor the Guidelines for Universal Service and Energy Conservation Programs *require that all customers with household income at or below* 150% of the Federal poverty guideline be eligible for *all* universal service and energy conservation policies, protections, and services.[57]

True enough, but the Guidelines do state that customers who are low-income and payment-troubled are eligible for CAP and Duquesne itself says that number is 115,055 customers and not the 5,731 Duquesne recognizes.

Mr. Flynn justifies Duquesne's additional eligibility criteria by noting:

> [t]he Commission's Guidelines specifically include "other non-income criteria" in the definition of eligibility. Accordingly, the Company has included such criteria to enable it to better target its resources and to maximize the likelihood of accomplishing its stated universal service goal.[58]

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[56]Duquesne Statement No. 14-R (Joseph Flynn), p. 8, l. 9.

[57]Duquesne Statement No. 14-R (Joseph Flynn), p. 8, l. 26-29.

[58]Duquesne Statement No. 14-R (Joseph Flynn), p. 9, l. 6-9.

This is a misreading of the Guidelines. As noted above, the Guidelines list the non-income eligibility criteria which apply for CAP and LIURP. The Guidelines then go on to list other factors for both CAP and LIURP which an EDC can use to prioritize the delivery of services, but these are not additional eligibility criteria. As Roger Colton noted:

> *Prioritizing* the enrollment based on one of the four articulated factors is completely different from restricting enrollment to those customers who meet only one of the four factors. To deny enrollment to someone who meets the three "eligibility" criteria articulated by the PUC but who does not meet the "prioritization" for enrollment is contrary to the PUC order.[59]

What Duquesne has done is take suggested "prioritization" factors and turned them into eligibility criteria and that is an error.

One additional general point must be made on the topic of program costs. At least three times in his rebuttal testimony, Mr. Flynn states that if the Company is directed to increase its universal service funding, it will "approach the PUC for relief from its rate cap to meet the need."[60] This statement is at direct odds with the Commission's Guidelines, which provides that:

> [f]unding for universal service and energy conservation programs should not be determined after all other funding requirements are met. The total amount of dollars available under the rate cap should be adjusted to meet all the requirements of the Act including universal service and energy conservation." If total expenditures by the Company

[59]City of Pittsburgh *et al.* Statement No. 3-R (Roger Colton), p. 4, l. 4-9.

[60]Duquesne Statement No. 14-R (Joseph Flynn), p. 3, l. 25-27. See also pp. 6 and 16.

> were to exceed the rate cap, Universal Service costs would be no more the "cause" than any other expenditure of the Company.[61]

The Environmentalists support the testimony of Roger Colton and his estimate of an "appropriately funded and available" budget should be for Duquesne's universal service programs. Based on the assumption that 50% of the customers who are eligible for each program will participate, Mr. Colton's recommended budget is $17.49 million.

Annual Budgets for an "Appropriately Funded and Available" Universal Service Program in the Duquesne Service Territory

	Duquesne	Environmentalists
CAP	$ 550,000	$ 14,750,000
LIURP	$ 700,000	$ 2,214,000.
CARES	$ 60,000	$ 60,000
Hardship	$ 65,000	$ 65,000
Credit Counseling	$ 6,000	$ 400,000
TOTALS	$ 1,381,000	$ 17,489,000

2. Cost Allocation and Rate Design

Duquesne proposes to collect the costs of its universal service programs in the rates of all ratepayers and this cost allocation is appropriate and correct. The cost of providing universal service is recognized as a "public service cost" in the Act.[62] As a

[61]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Appendix B, Section D(2), p. 35.

[62]66 Pa.C.S. §2802(17).

public service cost, all sectors of the public should bear the costs.[63] To support this conclusion, City of Pittsburgh witness Roger Colton presented a compelling argument that universal service is the compensation for the valuable public perquisites of eminent domain and the right to use public streets. These rights are of tremendous value to Duquesne and to all who receive service from Duquesne, for without them, all ratepayers would bear higher costs. As Mr. Colton testified, "[t]he commitment to universal service is simply the compensation to the public for having provided these public benefits."[64]

Some parties argue that the Act's prohibition against cost shifting means that universal service costs should be assessed only against the residential class. Their argument is based on the assumption that the universal service costs are exclusively residential costs, but as shown above, the entire system benefits and the program costs are appropriately called "public service costs" in the Act. There is no cost shifting if the costs appropriately belong to everyone.

This analysis is supported by the Universal Service Guidelines, which states:

> 1. The cost of an EDC's universal service and energy conservation programs should be allocated among the classes of the distribution company's ratepayers consistent with sound rate design principles and in accordance with the Act's prohibition against the interclass and intraclass cost transfer and the Act's rate cap...

[63]Another example of a public cost are the various economic development tariffs for "payment-troubled" industrials. These programs are included in the rates for all customers.

[64]City of Pittsburgh *et al.* Statement No. 2 (Roger Colton), p. 11, l. 13-14.

...

4. All customer classes should share in providing funding of universal service consistent with sound rate design principles and in accordance with the Act's prohibition against the interclass and intraclass cost transfer and the Act's rate cap.[65]

In the commentary section of the Order, the Commission cites a kWh assessment on all customer classes as violating this cost transfer principle since this sort of assessment "places a disproportionate responsibility for funding universal service and energy conservation programs on high kWh (high volume) users in violation of Section 1301."[66] In other words, a straight kWh assessment across *all* customer classes is rejected not because it assesses the industrial customers for universal service costs, but because under such a mechanism, industrial customers would pay more than their class's proper share of the costs. What the commentary indicates is allocating the universal service program costs among the various rate classes is acceptable provided it is done in accordance on a valid cost-of-service basis. Duquesne has done this, by determining each class's share of the universal service costs and then establishing a distinct kWh charge for each customer class.

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[65]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Appendix B, Section G(1) and (5), p. 40.

[66]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, p. 20. We believe the reference to "high volume users" refers to a class of customers (ie. industrial customers) rather than to individual customers. Individual customers who are high users pay more of the variable costs for everything than low consumption customers in that same class. We do not think the Guidelines were addressing this issue on an individual customer level.

C. Specific Programs

1. CAP

Other than the eligibility and budget issues discussed above, the Environmentalists believe that Duquesne's CAP is generally well designed and effective. We would like to see the program be modified to ensure that CAP operates closely with the other universal service programs. We suggest that all CAP recipients are referred to LIURP so that their usage can be reduced. We also oppose the use of prepaid meters and find them inappropriate for low income households.

2. LIURP

Other than the eligibility and budget issues discussed above, the Environmentalists believe that the Low-Income Usage Reduction Program is a cost-effective means of reducing the energy costs of low income households. Energy conservation, as well as bill subsidies, should be the core elements of the universal service program. Duquesne's LIURP program is seen as one of the state's most effective energy programs. The key is a highly skilled staff supported by proper tools and instrumentation, giving the program the ability to accurately diagnose a house's situation and recommend appropriate treatments.

3. Renewable Resources

The one explicit reference in the Act to renewable energy is found in the definition of the phrase "universal service and energy conservation."[67] The Universal Service Guidelines require the universal service plans to "propose how the application of renewable resources will be accommodated."[68] Duquesne's universal service plan brushes off this requirement by simply noting that "Duquesne Light has no existing renewable resource programs in place nor does it have any plans for any at this time."[69] The Environmentalists urge the Commission to direct Duquesne to develop and offer a renewable energy pilot program as a component of its universal service program. This pilot could offer renewable technologies such as solar domestic water heating, solar photovoltaics, wood-fired water and/or space heating, etc.

4. Provider of Last Resort

The Act includes requires each EDC to acquire electric energy at prevailing market prices to serve customers who do not obtain generation from another electric supplier.[70] The Commission's Universal Service Guidelines require that the

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[67]66 Pa.C.S. §2803, definition of "Universal service and energy conservation."

[68]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Section B(2)(b), p. 30.

[69]Duquesne Statement No. 14-R (Joseph Flynn), Exhibit JPF-1, p. 4.

[70]66 Pa.C.S. §2807(e)(3).

restructuring plans propose an initial supplier of last resort and address how it will be utilized.[71]

Duquesne's plan states that it "will fill this role by default" but the plan fails to describe how the "prevailing market rates" for this power will be determined and passed on to customers.[72] This is an important issue since it is likely that many low-income customers will, for a variety of reasons, will be unable to obtain their power from a EGS and instead will be in effect captive customers of Duquesne. For this reason, the universal service plan needs to address a fair and effective mechanism for obtaining power and charging market rates for it.

5. Low-Income Consumer Education

The Act includes consumer education as a component of the definition of universal service and energy conservation programs.[73] Accordingly, the Commission's Universal Service Guidelines require that the restructuring plans discuss an education program targeted to address the special needs of low-income customers, with a long discussion of the program content and various outreach strategies.[74] The low-income education section of Duquesne's plan consists of four sentences and barely

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[71]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Section B(2)(a), p. 30.

[72]Duquesne Statement No. 14-R (Joseph Flynn), Exhibit JPF-1, p. 4.

[73]66 Pa.C.S. §2803, definition of "Universal service and energy conservation."

[74]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Section B(2)(c), p. 30.

distinguished low-income education from its general restructuring effort.[75] The Environmentalists ask that the Commission reject this portion of the Duquesne plan and direct the Company to file a low-income education plan which complies with the Guidelines.[76]

6. Current Universal Service Policies and Protections

The Commission's Universal Service Guidelines cites a handful of Policy Statements and 19 different Secretarial Letters which, along with Chapter 56, make up the existing universal service and energy conservation policies, protections and services.[77] Duquesne's universal service plan acknowledges the applicability of Chapter 56, but is does not mention the other Policy Statements and Secretarial Letters cited in the Guidelines. The plan should be revised to include these other requirements.

D. Administration

The Environmentalists recommend that Duquesne contract out both the delivery and administration of the universal service programs. Duquesne contracts with a community-based group to be direct providers for LIURP, but all other universal service

[75]Duquesne Statement No. 14-R (Joseph Flynn), Exhibit JPF-1, p. 4.

[76]Duquesne Statement No. 14-R (Joseph Flynn), Exhibit JPF-1, p. 2.

[77]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Section B(1), pp. 29-30 and Appendix C.

programs will be delivered by Duquesne and Duquesne will continue as the administrator of all of the programs. The Environmentalists urge the Commission to restructure Duquesne's universal service program and to unbundle the administration of the program by requiring it to be contracted out to a qualified community-based organization. For the Environmentalists, the ideal candidate would be an experienced non-profit, community-based organization with both a strong track record in the provision of energy assistance, conservation and education programs.

E. Universal Service Program Advisory Panel

The Universal Service Guidelines require the EDCs to "create and maintain a *universal service program advisory panel to provide consultation and advice to the utility* regarding the scope, design and administration of its universal service programs."[78] Duquesne's universal service plan states that it "will establish an advisory panel" but the plan falls short of ensuring that the advisory group will play a meaningful role.[79] The Environmentalists suggest that additional discussion be added to ensure that the advisory panel is inclusive and balanced. The panel should meet as needed, but at least twice a year. Its meetings should be transcribed. The panel should present its recommendations in writing to Duquesne and the company should be required to respond in writing to the committee's recommendations.

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[78]Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Section J, p. 43.

[79]Duquesne Statement No. 14-R (Joseph Flynn), Exhibit JPF-1, p. 10.

F. Access to Competitive Markets

The Environmentalists assert that while not exactly a universal service program issue, one of the most important questions for low-income customers is whether they will have meaningful access to the competitive market. This issue involves both the portability of universal service benefits, EGS marketing practices and the educational program.

Portability refers to the ability of a low-income customer to "carry" his or her universal service benefits to an EGS other than the existing utility. Will the customer be able to apply the CAP benefits to the bill of an EGS and will the benefits be as large as they would have been if the customer was receiving service from the EDC? Can a customer receive LIURP treatments even if they are receiving service from an EGC? The issue is whether the low-income customer is a captive customer of the LDC, because to leave the LDC is to lose some of the universal service benefits.

The other aspect of the access issue is the policies of the EGSs. Will the EGSs be challenged if they engage in redlining, or will the Commission look the other way? Will the EGSs be allowed to set credit standards, or minimum usage levels, or one of many other strategies to avoid the low-income customers with their low energy use and their history of bill payment problems? In some respects these two issues are related, for the willingness an EGS has to serve low-income customers is dependent on the ability to receive its fair share of the customer's universal service benefits.

As for education, will we see a portion of the educational program targeted to the special issues and needs of low-income customers so that the message reaches them?

One of the real tests of success for restructuring will be whether low-income customers have meaningful choices in the new market, or does our benign neglect leave then captives of the utility. The Environmentalists hope that the Commission watches these developments very carefully and acts promptly to protect the right to choice by the low-income customers.

XI. CUSTOMER EDUCATION

A. Scope of Customer Education

1. Introduction

Consumer information and education were important components of the Act, which clearly recognized that they were vital to the success of restructuring. Recognizing that consumers need an educational foundation for the purchasing and other market decisions they will soon be called upon to make, the Act requires that:

> [p]rior to the implementation of any restructuring plan under section 2806 (relating to implementation, pilot program and performance-based rates), each electric distribution company, in conjunction with the commission, shall implement a consumer education program informing customers of the changes in the electric utility industry. The program shall provide consumers with information necessary to help them make appropriate choices as to their electric service.[80]

[80] 66 Pa.C.S. §2807(d)(3).

In addition to the education program responsibility, the Act made the Commission responsible for ensuring that consumers have quality information to help them make sound decisions in the new marketplace. The Commission was directed to promulgate regulations:

> ... to require each electric distribution company, electricity supplier, marketer, aggregator and broker to provide *adequate and accurate customer information to enable* customers to make informed choices regarding the purchase of all electricity services offered by that provider. Information shall be provided to consumers in an understandable format that enables consumers to compare prices and services on *a uniform* basis.[81]

2. State-Wide v. Company Specific

The importance of educated consumers and access to objective, understandable information was certainly reinforced by the recent experience with the retail access pilot programs. One need look no further than the barrage of confusing and empty advertisements which have been flooding over us in the pilot programs to see that the Act was correct. An active Commission role is appropriate and necessary. Consumers *are clamoring for accurate information in an uniform and understandable format.* Without it, many of those who volunteered for the pilot programs are giving up and dropping out. There should be no lingering doubts that the Commission must implement a state-wide consumer education program.[82]

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[81]66 Pa.C.S. §2807(d)(2)

[82]The Commission has opened several generic dockets to address the education and information issues and the Environmentalists have participated (and will continue to participate) in those proceedings.

B. Implementation Issues

One curious aspect of this proceeding is that Duquesne has not submitted its plan for an education program either as part of its restructuring filing, the direct testimony of Frank Hoffman, the rebuttal testimony of Mr. Hoffman, or as in response to an OCA data request.[83] which the Environmentalists contend is inadequate. The education plan should have the following components:

1. Consumer Research

As described in the testimony of Roger Colton[84] and Barbara Alexander[85], the first step in the development of a quality consumer education plan should be consumer research to determine what consumers already know, what other information they want to know, and whom they trust for their information. This type of baseline data survey is critical in the design of a good program because you cannot decide how to get to where you want to be unless you first know where you are. A number of states have already conducted such research, and it should be reviewed for its lessons. Duquesne should also conduct its own research of its own customers.

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[83]OCA Statement 5-A (Barbara Alexander), p. 3, l. 8-11.

[84]City of Pittsburgh et al. Statement No. 2 (Roger Colton), p. 24, l. 13-19.

[85]OCA Statements 5 and 5-A (Barbara Alexander).

2. Education Plan

The Environmentalists suggest that after the consumer research is completed, an education plan should be drafted to address the following issues:

a. Goals and Objectives - using the customer research, set the specific goals and objectives for the program. Also identify strategies and tactics

b. A Staged or Phased Message

c. Specific Themes and Content for Each Phase

d. Delivery Mechanisms for Each Message

e. Evaluation and Feedback

f. Identification of In-House Staff and outside consultants

g. Identification of Advisory Counsel

C. Funding Levels and Recovery

The Environmentalists support an education budget for the four year program of at least $5 per customer. The PECO education budget is $5.33 per customer.[86]

The Environmentalists support the Commission's 65/35 split contained in the PECO restructuring order.[87]

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[86]Application of PECO Energy for Approval of its Restructuring Plan, Docket No. R-00973953, Opinion and Order (entered December 23, 1997), p. 151.

[87]Application of PECO Energy for Approval of its Restructuring Plan, Docket No. R-00973953, Opinion and Order (entered December 23, 1997), p. 153.

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

CERTIFICATE OF SERVICE

I hereby certify that I have, served the Brief of the Environmentalists in the above-referenced docket upon the following persons, in the manner specified and on the dates indicated:

Service by Federal Express Overnight Mail for Delivery on February 10, 1998:

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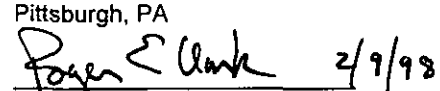

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February 10, 1998

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Via Hand Delivery

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Via Facsimile Transmission

Honorable John H. Corbett, Jr.
Administrative Law Judge
Pennsylvania Public Utility Commission
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Pittsburgh, PA 15222

RE: Pennsylvania Public Utility Commission v. Duquesne Light Company; Application for Approval of Restructuring Plan Under Section 2806 of the Public Utility Code; Docket No. R-00974104; MAIN BRIEF OF THE MID-ATLANTIC POWER SUPPLY ASSOCIATION (AMENDED CERTIFICATE OF SERVICE)

Dear Mr. McNulty and Judge Corbett:

On Monday, February 9, 1998, we filed, on behalf of the Mid-Atlantic Power Supply Association, a Main Brief in the above-referenced proceeding. Attached to that Main Brief was a Certificate of Service which indicated that the parties to this proceeding had been served by First Class Mail. That Certificate of Service was in error. In fact, all parties to this proceeding, including the ALJ, were served by Federal Express. The only exception to this method of service was the service to the Commission, which was performed by hand delivery.

Please consider this letter to be a modification of the aforementioned Certificate of Service. As indicated by the attached Certificate of Service, all parties to this proceeding have been served with a copy this letter. If you have any questions concerning this modification, please direct them to me. Thank you for your attention to this matter.

DOCKETED
FEB 13 1998

Very truly yours,

Todd S. Stewart
Counsel for the Mid-Atlantic Power Supply Association

TSS/bes
Attachment
cc: Attached Certificate of Service

DOCUMENT FOLDER

CERTIFICATE OF SERVICE

I hereby certify that this day a copy of the foregoing Main Brief of the Mid-Atlantic Power Supply Association on behalf of Duquesne Light Company has been served upon the persons and in the manner indicated below.

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